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108TH CONGRESS
1ST SESSION

H. R. 2896

[Report No. 108-393]

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

IN THE HOUSE OF REPRESENTATIVES

JULY 25, 2003

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

NOVEMBER 21, 2003

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italics]

[For text of introduced bill, see copy of bill as introduced on July 25, 2003]

A BILL

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

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

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

2 (a) *SHORT TITLE.*—*This Act may be cited as the*
 3 *“American Jobs Creation Act of 2003”.*

4 (b) *AMENDMENT OF 1986 CODE.*—*Except as otherwise*
 5 *expressly provided, whenever in this Act an amendment or*
 6 *repeal is expressed in terms of an amendment to, or repeal*
 7 *of, a section or other provision, the reference shall be consid-*
 8 *ered to be made to a section or other provision of the Inter-*
 9 *nal Revenue Code of 1986.*

10 (c) *TABLE OF CONTENTS.*—

Sec. 1. Short title; etc.

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Subtitle C—Depreciation

Sec. 1021. Recovery period for depreciation of certain leasehold improvements and restaurant property.

Subtitle D—Alternative Minimum Tax Relief

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Sec. 1032. Expansion of exemption from alternative minimum tax for small corporations.

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- Sec. 1046. Use of passive activity loss and at-risk amounts by qualified subchapter S trust income beneficiaries.*
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- Sec. 1072. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company income rules.*
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- Sec. 1078. Modification of subpart F exemption for active financing.*
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Subtitle H—Reduction of Double Taxation of Earnings

- Sec. 1081. Interest expense allocation rules.*
- Sec. 1082. Recharacterization of overall domestic loss.*
- Sec. 1083. Reduction to 2 foreign tax credit baskets.*
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- Sec. 1086. Clarification of treatment of certain transfers of intangible property.*
- Sec. 1087. United States property not to include certain assets acquired by dealers in ordinary course of trade or business.*
- Sec. 1088. Election not to use average exchange rate for foreign tax paid other than in functional currency.*
- Sec. 1089. Repeal of withholding tax on dividends from certain foreign corporations.*
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Sec. 3034. Exclusion from gross income for interest on overpayments of income tax by individuals.
Sec. 3035. Deposits made to suspend running of interest on potential underpayments.
Sec. 3036. Partial payment of tax liability in installment agreements.
Sec. 3037. Extension of IRS user fees.

TITLE IV—TRADE ENHANCEMENT AND COMPLIANCE PROVISIONS

- Sec. 4001. Repeal of exclusion for extraterritorial income.*
Sec. 4002. COBRA fees.

1 **TITLE I—CORPORATE REFORM**
2 **AND GROWTH INCENTIVES**
3 **Subtitle A—Reduction in Corporate**
4 **Income Tax Rates**
5 **SEC. 1001. REDUCED CORPORATE INCOME TAX RATE FOR**
6 **DOMESTIC PRODUCTION ACTIVITIES INCOME.**
7 **(a) LIMITATION ON TAX ON QUALIFIED PRODUCTION**
8 **ACTIVITIES INCOME.—Section 11 is amended by redesigning**

1 *nating subsections (c) and (d) as subsections (d) and (e),*
2 *respectively, and by inserting after subsection (b) the fol-*
3 *lowing new subsection:*

4 “(c) *LIMITATION ON TAX ON QUALIFIED PRODUCTION*
5 *ACTIVITIES INCOME.—*

6 “(1) *IN GENERAL.—If a corporation has quali-*
7 *fied production activities income for any taxable*
8 *year, the tax imposed by this section shall not exceed*
9 *the sum of—*

10 “(A) *a tax computed at the rates and in the*
11 *manner as if this subsection had not been en-*
12 *acted on the taxable income reduced by the*
13 *amount of qualified production activities income,*
14 *plus*

15 “(B) *a tax equal to 32 percent (34 percent*
16 *in the case of taxable years beginning before*
17 *January 1, 2007) of the qualified production ac-*
18 *tivities income (or, if less, taxable income).*

19 “(2) *QUALIFIED PRODUCTION ACTIVITIES IN-*
20 *COME.—*

21 “(A) *IN GENERAL.—The term ‘qualified*
22 *production activities income’ for any taxable*
23 *year means an amount equal to the excess (if*
24 *any) of—*

1 “(i) the taxpayer’s domestic production
2 gross receipts for such taxable year, over

3 “(ii) the sum of—

4 “(I) the cost of goods sold that are
5 allocable to such receipts,

6 “(II) other deductions, expenses,
7 or losses directly allocable to such re-
8 ceipts, and

9 “(III) a ratable portion of other
10 deductions, expenses, and losses that
11 are not directly allocable to such re-
12 ceipts or another class of income.

13 “(B) ALLOCATION METHOD.—The Secretary
14 shall prescribe rules for the proper allocation of
15 items of income, deduction, expense, and loss for
16 purposes of determining income attributable to
17 domestic production activities.

18 “(3) DOMESTIC PRODUCTION GROSS RECEIPTS.—
19 For purposes of this subsection, the term ‘domestic
20 production gross receipts’ means the gross receipts of
21 the taxpayer which are derived from—

22 “(A) any lease, rental, license, sale, ex-
23 change, or other disposition of—

24 “(i) qualifying production property
25 which was manufactured, produced, grown,

1 *or extracted in whole or in significant part*
2 *by the taxpayer within the United States,*
3 *or*

4 *“(ii) any qualified film produced by*
5 *the taxpayer, or*

6 *“(B) construction, engineering, or architec-*
7 *tural services performed in the United States for*
8 *construction projects in the United States.*

9 *“(4) QUALIFYING PRODUCTION PROPERTY.—For*
10 *purposes of this subsection, the term ‘qualifying pro-*
11 *duction property’ means—*

12 *“(A) tangible personal property,*

13 *“(B) any computer software, and*

14 *“(C) any property described in section*
15 *168(f)(4).*

16 *“(5) QUALIFIED FILM.—For purposes of this*
17 *subsection—*

18 *“(A) IN GENERAL.—The term ‘qualified*
19 *film’ means any property described in section*
20 *168(f)(3) if not less than 50 percent of the total*
21 *compensation relating to the production of such*
22 *property is compensation for services performed*
23 *in the United States by actors, production per-*
24 *sonnel, directors, and producers.*

1 “(B) *EXCEPTION.*—*Such term does not in-*
2 *clude property with respect to which records are*
3 *required to be maintained under section 2257 of*
4 *title 18, United States Code.*

5 “(6) *RELATED PERSONS.*—*For purposes of this*
6 *subsection—*

7 “(A) *IN GENERAL.*—*The term ‘domestic pro-*
8 *duction gross receipts’ shall not include any*
9 *gross receipts of the taxpayer derived from prop-*
10 *erty leased, licensed, or rented by the taxpayer*
11 *for use by any related person.*

12 “(B) *RELATED PERSON.*—*For purposes of*
13 *subparagraph (A), a person shall be treated as*
14 *related to another person if such persons are*
15 *treated as a single employer under subsection (a)*
16 *or (b) of section 52 or subsection (m) or (o) of*
17 *section 414, except that determinations under*
18 *subsections (a) and (b) of section 52 shall be*
19 *made without regard to section 1563(b).”.*

20 “(b) *SPECIAL RULE RELATING TO ELECTION TO TREAT*
21 *CUTTING OF TIMBER AS A SALE OR EXCHANGE.*—*In the*
22 *case of a corporation, any election under section 631(a) of*
23 *the Internal Revenue Code of 1986 made for a taxable year*
24 *ending on or before the date of the enactment of this Act*
25 *may be revoked by the taxpayer for any taxable year ending*

1 *after such date. For purposes of determining whether such*
 2 *taxpayer may make a further election under such section,*
 3 *such election (and any revocation under this section) shall*
 4 *not be taken into account.*

5 (c) *EFFECTIVE DATE.*—*The amendment made by this*
 6 *section shall apply to taxable years beginning after Decem-*
 7 *ber 31, 2003.*

8 **SEC. 1002. REDUCED CORPORATE INCOME TAX RATE FOR**
 9 **SMALL CORPORATIONS.**

10 (a) *IN GENERAL.*—*Subsection (b) of section 11 (relat-*
 11 *ing to tax imposed on corporations) is amended by redesi-*
 12 *gnating paragraph (2) as paragraph (6) and by striking*
 13 *paragraph (1) and inserting the following new paragraphs:*

14 “(1) *FOR TAXABLE YEARS BEGINNING AFTER*
 15 *2011.*—*In the case of taxable years beginning after*
 16 *2011, the amount of the tax imposed by subsection (a)*
 17 *shall be determined in accordance with the following*
 18 *table:*

<i>If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over</i> <i>\$50,000.</i>
<i>Over \$75,000 but not over</i> <i>\$20,000,000.</i>	<i>\$13,750, plus 32% of the excess over</i> <i>\$75,000.</i>
<i>Over \$20,000,000</i>	<i>\$6,389,750, plus 35% of the excess over</i> <i>\$20,000,000.</i>

19 “(2) *FOR TAXABLE YEARS BEGINNING IN 2009,*
 20 *2010, OR 2011.*—*In the case of taxable years beginning*
 21 *in 2009, 2010, or 2011, the amount of the tax im-*

1 *posed by subsection (a) shall be determined in accord-*
 2 *ance with the following table:*

<i>“If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over \$50,000.</i>
<i>Over \$75,000 but not over \$5,000,000.</i>	<i>\$13,750, plus 32% of the excess over \$75,000.</i>
<i>Over \$5,000,000 but not over \$10,000,000.</i>	<i>\$1,589,750, plus 34% of the excess over \$5,000,000.</i>
<i>Over \$10,000,000</i>	<i>\$3,289,750, plus 35% of the excess over \$10,000,000.</i>

3 *“(3) FOR TAXABLE YEARS BEGINNING IN 2007 OR*
 4 *2008.—In the case of taxable years beginning in 2007*
 5 *or 2008, the amount of the tax imposed by subsection*
 6 *(a) shall be determined in accordance with the fol-*
 7 *lowing table:*

<i>“If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over \$50,000.</i>
<i>Over \$75,000 but not over \$1,000,000.</i>	<i>\$13,750, plus 32% of the excess over \$75,000.</i>
<i>Over \$1,000,000 but not over \$10,000,000.</i>	<i>\$309,750, plus 34% of the excess over \$1,000,000.</i>
<i>Over \$10,000,000</i>	<i>\$3,369,750, plus 35% of the excess over \$10,000,000.</i>

8 *“(4) FOR TAXABLE YEARS BEGINNING IN 2004,*
 9 *2005, OR 2006.—In the case of taxable years beginning*
 10 *in 2004, 2005, or 2006, the amount of the tax im-*
 11 *posed by subsection (a) shall be determined in accord-*
 12 *ance with the following table:*

<i>“If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over \$50,000.</i>
<i>Over \$75,000 but not over \$1,000,000.</i>	<i>\$13,750, plus 33% of the excess over \$75,000.</i>

<i>If taxable income is:</i>	<i>The tax is:</i>
Over \$1,000,000 but not over \$10,000,000.	\$319,000, plus 34% of the excess over \$1,000,000.
Over \$10,000,000	\$3,379,000, plus 35% of the excess over \$10,000,000.

1 “(5) PHASEOUT OF LOWER RATES FOR CERTAIN
2 TAXPAYERS.—

3 “(A) GENERAL RULE FOR YEARS BEFORE
4 2012.—

5 “(i) IN GENERAL.—*In the case of tax-*
6 *able years beginning before 2012 with re-*
7 *spect to a corporation which has taxable in-*
8 *come in excess of the applicable amount for*
9 *any taxable year, the amount of tax deter-*
10 *mined under paragraph (1), (2), (3) or (4)*
11 *for such taxable year shall be increased by*
12 *the lesser of (I) 5 percent of such excess, or*
13 *(II) the maximum increase amount.*

14 “(ii) MAXIMUM INCREASE AMOUNT.—
15 *For purposes of clause (i)—*

<i>“In the case of any taxable year beginning during:</i>	<i>The applicable amount is:</i>	<i>The maximum increase amount is:</i>
2004, 2005, or 2006	\$1,000,000	\$21,000
2007 or 2008	\$1,000,000	\$30,250
2009, 2010, or 2011	\$5,000,000	\$110,250.

16 “(B) HIGHER INCOME CORPORATIONS.—*In*
17 *the case of a corporation which has taxable in-*
18 *come in excess of \$20,000,000 (\$15,000,000 in*
19 *the case of taxable years beginning before 2012),*

1 *the amount of the tax determined under the fore-*
2 *going provisions of this subsection shall be in-*
3 *creased by an additional amount equal to the*
4 *lesser of (i) 3 percent of such excess, or (ii)*
5 *\$610,250 (\$100,000 in the case of taxable years*
6 *beginning before 2012).”.*

7 **(b) CONFORMING AMENDMENTS.—**

8 *(1) Section 904(b)(3)(D)(ii) is amended to read*
9 *as follows:*

10 *“(ii) in the case of a corporation, sec-*
11 *tion 1201(a) applies to such taxable year.”.*

12 *(2) Section 1201(a) is amended by striking “the*
13 *last 2 sentences of section 11(b)(1)” and inserting*
14 *“section 11(b)(5)”.*

15 *(3) Section 1561(a) is amended—*

16 *(A) by striking “the last 2 sentences of sec-*
17 *tion 11(b)(1)” and inserting “section 11(b)(5)”,*
18 *and*

19 *(B) by striking “such last 2 sentences” and*
20 *inserting “section 11(b)(5)”.*

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

1 **Subtitle B—Small Business**
2 **Expensing**

3 **SEC. 1011. 2-YEAR EXTENSION OF INCREASED EXPENSING**
4 **FOR SMALL BUSINESS.**

5 *Subsections (b), (c), and (d) of section 179 (as amend-*
6 *ed by the Jobs and Growth Tax Relief Reconciliation Act*
7 *of 2003) are each amended by striking “2006” each place*
8 *it appears and inserting “2008”.*

9 **Subtitle C—Depreciation**

10 **SEC. 1021. RECOVERY PERIOD FOR DEPRECIATION OF CER-**
11 **TAIN LEASEHOLD IMPROVEMENTS AND RES-**
12 **TAURANT PROPERTY.**

13 *(a) 15-YEAR RECOVERY PERIOD.—Subparagraph (E)*
14 *of section 168(e)(3) (relating to classification of certain*
15 *property) is amended by striking “and” at the end of clause*
16 *(ii), by striking the period at the end of clause (iii) and*
17 *inserting a comma, and by adding at the end the following*
18 *new clauses:*

19 *“(iv) any qualified leasehold improve-*
20 *ment property placed in service before Jan-*
21 *uary 1, 2006, and*

22 *“(v) any qualified restaurant property*
23 *placed in service before January 1, 2006.”*

1 (b) *QUALIFIED LEASEHOLD IMPROVEMENT PROP-*
2 *ERTY.—Subsection (e) of section 168 is amended by adding*
3 *at the end the following new paragraph:*

4 “(6) *QUALIFIED LEASEHOLD IMPROVEMENT*
5 *PROPERTY.—The term ‘qualified leasehold improve-*
6 *ment property’ has the meaning given such term in*
7 *section 168(k)(3) except that the following special*
8 *rules shall apply:*

9 “(A) *IMPROVEMENTS MADE BY LESSOR.—In*
10 *the case of an improvement made by the person*
11 *who was the lessor of such improvement when*
12 *such improvement was placed in service, such*
13 *improvement shall be qualified leasehold im-*
14 *provement property (if at all) only so long as*
15 *such improvement is held by such person.*

16 “(B) *EXCEPTION FOR CHANGES IN FORM OF*
17 *BUSINESS.—Property shall not cease to be quali-*
18 *fied leasehold improvement property under sub-*
19 *paragraph (A) by reason of—*

20 “(i) *death,*

21 “(ii) *a transaction to which section*
22 *381(a) applies,*

23 “(iii) *a mere change in the form of*
24 *conducting the trade or business so long as*
25 *the property is retained in such trade or*

1 *business as qualified leasehold improvement*
2 *property and the taxpayer retains a sub-*
3 *stantial interest in such trade or business,*

4 “*(iv) the acquisition of such property*
5 *in an exchange described in section 1031,*
6 *1033, or 1038 to the extent that the basis of*
7 *such property includes an amount rep-*
8 *resenting the adjusted basis of other prop-*
9 *erty owned by the taxpayer or a related*
10 *person, or*

11 “*(v) the acquisition of such property*
12 *by the taxpayer in a transaction described*
13 *in section 332, 351, 361, 721, or 731 (or the*
14 *acquisition of such property by the taxpayer*
15 *from the transferee or acquiring corporation*
16 *in a transaction described in such section),*
17 *to the extent that the basis of the property*
18 *in the hands of the taxpayer is determined*
19 *by reference to its basis in the hands of the*
20 *transferor or distributor.”.*

21 (c) *QUALIFIED RESTAURANT PROPERTY.*—Subsection
22 (i) of section 168 (as amended by subsection (b)) is further
23 amended by adding at the end the following new paragraph:

24 “(7) *QUALIFIED RESTAURANT PROPERTY.*—The
25 term ‘qualified restaurant property’ means any sec-

1 *tion 1250 property which is an improvement to a*
2 *building if—*

3 *“(A) such improvement is placed in service*
4 *more than 3 years after the date such building*
5 *was first placed in service, and*

6 *“(B) more than 50 percent of the building’s*
7 *square footage is devoted to preparation of, and*
8 *seating for on-premises consumption of, prepared*
9 *meals.”.*

10 *(d) REQUIREMENT TO USE STRAIGHT LINE METH-*
11 *OD.—*

12 *(1) Paragraph (3) of section 168(b) is amended*
13 *by adding at the end the following new subpara-*
14 *graphs:*

15 *“(G) Qualified leasehold improvement prop-*
16 *erty described in subsection (e)(6).*

17 *“(H) Qualified restaurant property de-*
18 *scribed in subsection (e)(7).”.*

19 *(2) Subparagraph (A) of section 168(b)(2) is*
20 *amended by inserting before the comma “not referred*
21 *to in paragraph (3)”.*

22 *(e) ALTERNATIVE SYSTEM.—The table contained in*
23 *section 168(g)(3)(B) is amended by adding at the end the*
24 *following new items:*

<i>“(E)(iv)</i>	<i>39</i>
<i>“(E)(v)</i>	<i>39”.</i>

1 (f) *EFFECTIVE DATE.*—*The amendments made by this*
 2 *section shall apply to property placed in service after the*
 3 *date of the enactment of this Act.*

4 ***Subtitle D—Alternative Minimum***
 5 ***Tax Relief***

6 ***SEC. 1031. NET OPERATING LOSSES AND FOREIGN TAX***
 7 ***CREDIT UNDER ALTERNATIVE MINIMUM TAX.***

8 (a) *NET OPERATING LOSSES.*—

9 (1) *IN GENERAL.*—*Subparagraph (A) of section*
 10 *56(d)(1) is amended to read as follows:*

11 “(A) *the amount of such deduction shall not*
 12 *exceed the applicable percentage (determined*
 13 *under paragraph (3)) of the alternative min-*
 14 *imum taxable income determined without regard*
 15 *to such deduction, and”.*

16 (2) *APPLICABLE PERCENTAGE.*—*Subsection (d)*
 17 *of section 56 is amended by adding at the end the fol-*
 18 *lowing new paragraph:*

19 “(3) *APPLICABLE PERCENTAGE.*—*For purposes*
 20 *of paragraph (1)(A)—*

<i>“For taxable years beginning in calendar year—</i>	<i>The applicable percentage is—</i>
<i>2005, 2006, or 2007</i>	<i>92</i>
<i>2008 or 2009</i>	<i>94</i>
<i>2010</i>	<i>96</i>
<i>2011</i>	<i>98</i>
<i>2012 or thereafter</i>	<i>100.”</i>

21 (b) *FOREIGN TAX CREDIT.*—

1 (1) *Subsection (a) of section 59 is amended by*
2 *striking paragraph (2) and by redesignating para-*
3 *graphs (3) and (4) as paragraphs (2) and (3), respec-*
4 *tively.*

5 (2) *Section 53(d)(1)(B)(i)(II) is amended by*
6 *striking “and if section 59(a)(2) did not apply”.*

7 (c) *EFFECTIVE DATE.—The amendments made by this*
8 *section shall apply to taxable years beginning after Decem-*
9 *ber 31, 2004.*

10 **SEC. 1032. EXPANSION OF EXEMPTION FROM ALTERNATIVE**
11 **MINIMUM TAX FOR SMALL CORPORATIONS.**

12 (a) *IN GENERAL.—Subparagraphs (A) and (B) of sec-*
13 *tion 55(e)(1) are each amended by striking “\$7,500,000”*
14 *each place it appears and inserting “\$20,000,000”.*

15 (b) *EFFECTIVE DATE.—The amendment made by this*
16 *section shall apply to taxable years beginning after Decem-*
17 *ber 31, 2004.*

18 **SEC. 1033. INCOME AVERAGING FOR FARMERS NOT TO IN-**
19 **CREASE ALTERNATIVE MINIMUM TAX.**

20 (a) *IN GENERAL.—Subsection (c) of section 55 (defin-*
21 *ing regular tax) is amended by redesignating paragraph*
22 *(2) as paragraph (3) and by inserting after paragraph (1)*
23 *the following new paragraph:*

24 “(2) *COORDINATION WITH INCOME AVERAGING*
25 *FOR FARMERS.—Solely for purposes of this section,*

1 “(B) MEMBERS OF THE FAMILY.—For pur-
2 pose of subparagraph (A)(i)—

3 “(i) IN GENERAL.—The term ‘members
4 of the family’ means the common ancestor,
5 lineal descendants of the common ancestor,
6 and the spouses (or former spouses) of such
7 lineal descendants or common ancestor.

8 “(ii) COMMON ANCESTOR.—For pur-
9 poses of this paragraph, an individual shall
10 not be considered a common ancestor if, as
11 of the later of the effective date of this para-
12 graph or the time the election under section
13 1362(a) is made, the individual is more
14 than 3 generations removed from the young-
15 est generation of shareholders who would
16 (but for this clause) be members of the fam-
17 ily. For purposes of the preceding sentence,
18 a spouse (or former spouse) shall be treated
19 as being of the same generation as the indi-
20 vidual to which such spouse is (or was)
21 married.

22 “(C) EFFECT OF ADOPTION, ETC.—In deter-
23 mining whether any relationship specified in
24 subparagraph (B) exists, the rules of section
25 152(b)(2) shall apply.

1 “(D) *ELECTION*.—An election under sub-
2 paragraph (A)(ii)—

3 “(i) may, except as otherwise provided
4 in regulations prescribed by the Secretary,
5 be made by any member of the family, and

6 “(ii) shall remain in effect until termi-
7 nated as provided in regulations prescribed
8 by the Secretary.”.

9 (b) *RELIEF FROM INADVERTENT INVALID ELECTION*
10 OR *TERMINATION*.—Section 1362(f) (relating to inadvertent
11 invalid elections or terminations), as amended by section
12 1049, is amended—

13 (1) by inserting “or section 1361(c)(1)(A)(ii)”
14 after “section 1361(b)(3)(B)(ii),” in paragraph (1),
15 and

16 (2) by inserting “or section 1361(c)(1)(D)(iii)”
17 after “section 1361(b)(3)(C),” in paragraph (1)(B).

18 (c) *EFFECTIVE DATES*.—

19 (1) *SUBSECTION (a)*.—The amendment made by
20 subsection (a) shall apply to taxable years beginning
21 after December 31, 2003.

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

1 **SEC. 1042. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
2 **HOLDERS TO 100.**

3 (a) *IN GENERAL.*—Section 1361(b)(1)(A) (defining
4 *small business corporation*) is amended by striking “75”
5 and inserting “100”.

6 (b) *EFFECTIVE DATE.*—The amendment made by this
7 section shall apply to taxable years beginning after Decem-
8 ber 31, 2003.

9 **SEC. 1043. EXPANSION OF BANK S CORPORATION ELIGIBLE**
10 **SHAREHOLDERS TO INCLUDE IRAS.**

11 (a) *IN GENERAL.*—Section 1361(c)(2)(A) (relating to
12 *certain trusts permitted as shareholders*) is amended by in-
13 *serting after clause (v) the following new clause:*

14 “(vi) *In the case of a corporation*
15 *which is a bank (as defined in section 581),*
16 *a trust which constitutes an individual re-*
17 *tirement account under section 408(a), in-*
18 *cluding one designated as a Roth IRA*
19 *under section 408A, but only to the extent*
20 *of the stock held by such trust in such bank*
21 *as of the date of the enactment of this*
22 *clause.”.*

23 (b) *TREATMENT AS SHAREHOLDER.*—Section
24 1361(c)(2)(B) (relating to *treatment as shareholders*) is
25 *amended by adding at the end the following new clause:*

1 “(vi) In the case of a trust described in
2 clause (vi) of subparagraph (A), the indi-
3 vidual for whose benefit the trust was cre-
4 ated shall be treated as a shareholder.”.

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

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

16 “(A) such stock is in a bank (as defined in
17 section 581),

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

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

22 “(D) such sale is for fair market value at
23 the time of sale (as established by an inde-
24 pendent appraiser) and the terms of the sale are
25 otherwise at least as favorable to such trust as

1 *the terms that would apply on a sale to an unre-*
2 *lated party,*

3 “(E) *such trust does not pay any commis-*
4 *sions, costs, or other expenses in connection with*
5 *the sale, and*

6 “(F) *the stock is sold in a single transaction*
7 *for cash not later than 120 days after the S cor-*
8 *poration election is made.”.*

9 (d) *CONFORMING AMENDMENT.*—Section 512(e)(1) is
10 *amended by inserting “1361(c)(2)(A)(vi) or” before*
11 *“1361(c)(6)”.*

12 (e) *EFFECTIVE DATE.*—*The amendments made by this*
13 *section shall take effect on the date of the enactment of this*
14 *Act.*

15 **SEC. 1044. DISREGARD OF UNEXERCISED POWERS OF AP-**
16 **POINTMENT IN DETERMINING POTENTIAL**
17 **CURRENT BENEFICIARIES OF ESBT.**

18 (a) *IN GENERAL.*—Section 1361(e)(2) (*defining poten-*
19 *tial current beneficiary*) is amended—

20 (1) *by inserting “(determined without regard to*
21 *any power of appointment to the extent such power*
22 *remains unexercised at the end of such period)” after*
23 *“of the trust” in the first sentence, and*

24 (2) *by striking “60-day” in the second sentence*
25 *and inserting “1-year”.*

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

4 **SEC. 1045. TRANSFER OF SUSPENDED LOSSES INCIDENT TO**
5 **DIVORCE, ETC.**

6 (a) *IN GENERAL.*—*Section 1366(d)(2) (relating to in-*
7 *definite carryover of disallowed losses and deductions) is*
8 *amended to read as follows:*

9 “(2) *INDEFINITE CARRYOVER OF DISALLOWED*
10 *LOSSES AND DEDUCTIONS.*—

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

17 “(B) *TRANSFERS OF STOCK BETWEEN*
18 *SPOUSES OR INCIDENT TO DIVORCE.*—*In the case*
19 *of any transfer described in section 1041(a) of*
20 *stock of an S corporation, any loss or deduction*
21 *described in subparagraph (A) with respect such*
22 *stock shall be treated as incurred by the corpora-*
23 *tion in the succeeding taxable year with respect*
24 *to the transferee.”*

1 (b) *EFFECTIVE DATE.*—*The amendment made by this*
2 *section shall apply to taxable years beginning after Decem-*
3 *ber 31, 2003.*

4 **SEC. 1046. USE OF PASSIVE ACTIVITY LOSS AND AT-RISK**
5 **AMOUNTS BY QUALIFIED SUBCHAPTER S**
6 **TRUST INCOME BENEFICIARIES.**

7 (a) *IN GENERAL.*—*Section 1361(d)(1) (relating to spe-*
8 *cial rule for qualified subchapter S trust) is amended—*

9 (1) *by striking “and” at the end of subpara-*
10 *graph (A),*

11 (2) *by striking the period at the end of subpara-*
12 *graph (B) and inserting “, and”, and*

13 (3) *by adding at the end the following new sub-*
14 *paragraph:*

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

20 (b) *EFFECTIVE DATE.*—*The amendments made by this*
21 *section shall apply to transfers made after December 31,*
22 *2003.*

1 **SEC. 1047. EXCLUSION OF INVESTMENT SECURITIES IN-**
2 **COME FROM PASSIVE INCOME TEST FOR**
3 **BANKS CORPORATIONS.**

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

9 “(F) *EXCEPTION FOR BANKS; ETC.*—In the
10 case of a bank (as defined in section 581), a
11 bank holding company (within the meaning of
12 section 2(a) of the Bank Holding Company Act
13 of 1956 (12 U.S.C. 1841(a))), or a financial
14 holding company (within the meaning of section
15 2(p) of such Act), the term ‘passive investment
16 income’ shall not include—

17 “(i) interest income earned by such
18 bank or company, or

19 “(ii) dividends on assets required to be
20 held by such bank or company, including
21 stock in the Federal Reserve Bank, the Fed-
22 eral Home Loan Bank, or the Federal Agri-
23 cultural Mortgage Bank or participation
24 certificates issued by a Federal Intermediate
25 Credit Bank.”.

1 (b) *EFFECTIVE DATE.*—*The amendment made by this*
2 *section shall apply to taxable years beginning after Decem-*
3 *ber 31, 2003.*

4 **SEC. 1048. TREATMENT OF BANK DIRECTOR SHARES.**

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

8 “(f) *RESTRICTED BANK DIRECTOR STOCK.*—

9 “(1) *IN GENERAL.*—*Restricted bank director*
10 *stock shall not be taken into account as outstanding*
11 *stock of the S corporation in applying this subchapter*
12 *(other than section 1368(f)).*

13 “(2) *RESTRICTED BANK DIRECTOR STOCK.*—*For*
14 *purposes of this subsection, the term ‘restricted bank*
15 *director stock’ means stock in a bank (as defined in*
16 *section 581), a bank holding company (within the*
17 *meaning of section 2(a) of the Bank Holding Com-*
18 *pany Act of 1956 (12 U.S.C. 1841(a)), or a financial*
19 *holding company (within the meaning of section 2(p)*
20 *of such Act), registered with the Federal Reserve Sys-*
21 *tem if such stock—*

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

1 “(B) is subject to an agreement with such
2 bank or company (or a corporation which con-
3 trols (within the meaning of section 368(c)) such
4 bank or company) pursuant to which the holder
5 is required to sell back such stock (at the same
6 price as the individual acquired such stock) upon
7 ceasing to hold the office of director.

8 “(3) CROSS REFERENCE.—

**“For treatment of certain distributions with re-
spect to restricted bank director stock, see section
1368(f).”.**

9 (b) DISTRIBUTIONS.—Section 1368 (relating to dis-
10 tributions) is amended by adding at the end the following
11 new subsection:

12 “(f) RESTRICTED BANK DIRECTOR STOCK.—If a di-
13 rector receives a distribution (not in part or full payment
14 in exchange for stock) from an S corporation with respect
15 to any restricted bank director stock (as defined in section
16 1361(f)), the amount of such distribution—

17 “(1) shall be includible in gross income of the di-
18 rector, and

19 “(2) shall be deductible by the corporation for the
20 taxable year of such corporation in which or with
21 which ends the taxable year in which such amount in
22 included in the gross income of the director.”.

1 (c) *EFFECTIVE DATE.*—*The amendments made by this*
2 *section shall apply to taxable years beginning after Decem-*
3 *ber 31, 2003.*

4 **SEC. 1049. RELIEF FROM INADVERTENTLY INVALID QUALI-**
5 **FIED SUBCHAPTER S SUBSIDIARY ELECTIONS**
6 **AND TERMINATIONS.**

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

9 (1) *by inserting “, section 1361(b)(3)(B)(ii),”*
10 *after “subsection (a)” in paragraph (1),*

11 (2) *by inserting “, section 1361(b)(3)(C),” after*
12 *“subsection (d)” in paragraph (1)(B),*

13 (3) *by amending paragraph (3)(A) to read as*
14 *follows:*

15 “(A) *so that the corporation for which the*
16 *election was made is a small business corpora-*
17 *tion or a qualified subchapter S subsidiary, as*
18 *the case may be, or”,*

19 (4) *by amending paragraph (4) to read as fol-*
20 *lows:*

21 “(4) *the corporation for which the election was*
22 *made, and each person who was a shareholder in such*
23 *corporation at any time during the period specified*
24 *pursuant to this subsection, agrees to make such ad-*
25 *justments (consistent with the treatment of such cor-*

1 *poration as an S corporation or a qualified sub-*
 2 *chapter S subsidiary, as the case may be) as may be*
 3 *required by the Secretary with respect to such pe-*
 4 *riod,”, and*

5 *(5) by inserting “or a qualified subchapter S*
 6 *subsidiary, as the case may be” after “S corporation”*
 7 *in the matter following paragraph (4).*

8 *(b) EFFECTIVE DATE.—The amendments made by this*
 9 *section shall apply to taxable years beginning after Decem-*
 10 *ber 31, 2003.*

11 **SEC. 1050. INFORMATION RETURNS FOR QUALIFIED SUB-**
 12 **CHAPTER S SUBSIDIARIES.**

13 *(a) IN GENERAL.—Section 1361(b)(3)(A) (relating to*
 14 *treatment of certain wholly owned subsidiaries) is amended*
 15 *by inserting “and in the case of information returns re-*
 16 *quired under part III of subchapter A of chapter 61” after*
 17 *“Secretary”.*

18 *(b) EFFECTIVE DATE.—The amendment made by this*
 19 *section shall apply to taxable years beginning after Decem-*
 20 *ber 31, 2003.*

21 **SEC. 1051. REPAYMENT OF LOANS FOR QUALIFYING EM-**
 22 **PLOYER SECURITIES.**

23 *(a) IN GENERAL.—Subsection (f) of section 4975 (re-*
 24 *lating to other definitions and special rules) is amended*
 25 *by adding at the end the following new paragraph:*

1 “(7) *S CORPORATION REPAYMENT OF LOANS FOR*
2 *QUALIFYING EMPLOYER SECURITIES.*—*A plan shall*
3 *not be treated as violating the requirements of section*
4 *401 or 409 or subsection (e)(7), or as engaging in a*
5 *prohibited transaction for purposes of subsection*
6 *(d)(3), merely by reason of any distribution (as de-*
7 *scribed in section 1368(a)) with respect to S corpora-*
8 *tion stock that constitutes qualifying employer securi-*
9 *ties, which in accordance with the plan provisions is*
10 *used to make payments on a loan described in sub-*
11 *section (d)(3) the proceeds of which were used to ac-*
12 *quire such qualifying employer securities (whether or*
13 *not allocated to participants). The preceding sentence*
14 *shall not apply in the case of a distribution which is*
15 *paid with respect to any employer security which is*
16 *allocated to a participant unless the plan provides*
17 *that employer securities with a fair market value of*
18 *not less than the amount of such distribution are allo-*
19 *cated to such participant for the year which (but for*
20 *the preceding sentence) such distribution would have*
21 *been allocated to such participant.”.*

22 **(b) EFFECTIVE DATE.**—*The amendment made by this*
23 *section shall apply to distributions with respect to S cor-*
24 *poration stock made after December 31, 2003.*

1 ***Subtitle F—Protecting Employee***
2 ***Benefits***

3 ***SEC. 1061. TREATMENT OF NONQUALIFIED DEFERRED COM-***
4 ***PENSATION PLANS.***

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

8 ***“SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED***
9 ***COMPENSATION UNDER NONQUALIFIED DE-***
10 ***FERRED COMPENSATION PLANS.***

11 *“(a) RULES RELATING TO CONSTRUCTIVE RECEIPT.—*

12 *“(1) IN GENERAL.—*

13 *“(A) GROSS INCOME INCLUSION.—In the*
14 *case of a nonqualified deferred compensation*
15 *plan, all compensation deferred under the plan*
16 *for all taxable years (to the extent not subject to*
17 *a substantial risk of forfeiture and not pre-*
18 *viously included in gross income) shall be in-*
19 *cludible in gross income for the taxable year un-*
20 *less at all times during the taxable year the plan*
21 *meets the requirements of paragraphs (2), (3),*
22 *and (4) and is operated in accordance with such*
23 *requirements.*

1 “(B) *INTEREST ON TAX LIABILITY PAYABLE*
2 *WITH RESPECT TO PREVIOUSLY DEFERRED COM-*
3 *PENSATION.—*

4 “(i) *IN GENERAL.—If compensation is*
5 *required to be included in gross income*
6 *under subparagraph (A) for a taxable year,*
7 *the tax imposed by this chapter for such*
8 *taxable year shall be increased by the*
9 *amount of interest determined under clause*
10 *(ii).*

11 “(ii) *INTEREST.—For purposes of*
12 *clause (i), the interest determined under*
13 *this clause for any taxable year is the*
14 *amount of interest at the underpayment*
15 *rate plus 1 percentage point on the under-*
16 *payments that would have occurred had the*
17 *deferred compensation been includible in*
18 *gross income for the taxable year in which*
19 *first deferred or, if later, the first taxable*
20 *year in which such deferred compensation is*
21 *not subject to a substantial risk of for-*
22 *feiture.*

23 “(2) *DISTRIBUTIONS.—*

24 “(A) *IN GENERAL.—The requirements of*
25 *this paragraph are met if the plan provides that*

1 *compensation deferred under the plan may not*
2 *be distributed earlier than—*

3 “(i) *separation from service as deter-*
4 *mined by the Secretary (except as provided*
5 *in subparagraph (B)(i)),*

6 “(ii) *disability (as defined by section*
7 *223(d) of the Social Security Act),*

8 “(iii) *death,*

9 “(iv) *a specified time (or pursuant to*
10 *a fixed schedule) specified under the plan at*
11 *the date of the deferral of such compensa-*
12 *tion,*

13 “(v) *to the extent provided by the Sec-*
14 *retary, a change in the ownership or effec-*
15 *tive control of the corporation, or in the*
16 *ownership of a substantial portion of the as-*
17 *sets of the corporation, or*

18 “(vi) *the occurrence of an unforeseeable*
19 *emergency.*

20 “(B) *SPECIAL RULES.—*

21 “(i) *SPECIFIED EMPLOYEES.—In the*
22 *case of specified employees, the requirement*
23 *of subparagraph (A)(i) is met only if dis-*
24 *tributions may not be made earlier than 6*
25 *months after the date of separation from*

1 *service. For purposes of the preceding sen-*
2 *tence, a specified employee is a key em-*
3 *ployee (as defined in section 416(i)) of a*
4 *corporation the stock in which is publicly*
5 *traded on an established securities market*
6 *or otherwise.*

7 “(i) *UNFORESEEABLE EMERGENCY.—*
8 *For purposes of subparagraph (A)(vi)—*

9 “(I) *IN GENERAL.—The term ‘un-*
10 *foreseeable emergency’ means a severe*
11 *financial hardship to the participant*
12 *resulting from a sudden and unex-*
13 *pected illness or accident of the partici-*
14 *part, the participant’s spouse, or a de-*
15 *pendent (as defined in section 152(a))*
16 *of the participant, loss of the partici-*
17 *part’s property due to casualty, or*
18 *other similar extraordinary and un-*
19 *foreseeable circumstances arising as a*
20 *result of events beyond the control of*
21 *the participant.*

22 “(II) *LIMITATION ON DISTRIBUTIONS.—The requirement of subpara-*
23 *graph (A)(vi) is met only if, as deter-*
24 *mined under regulations of the Sec-*
25

1 *retary, the amounts distributed with*
2 *respect to an emergency do not exceed*
3 *the amounts necessary to satisfy such*
4 *emergency plus amounts necessary to*
5 *pay taxes reasonably anticipated as a*
6 *result of the distribution, after taking*
7 *into account the extent to which such*
8 *hardship is or may be relieved through*
9 *reimbursement or compensation by in-*
10 *surance or otherwise or by liquidation*
11 *of the participant's assets (to the extent*
12 *the liquidation of such assets would not*
13 *itself cause severe financial hardship).*

14 *“(3) ACCELERATION OF BENEFITS.—The require-*
15 *ments of this paragraph are met if the plan does not*
16 *permit the acceleration of the time or schedule of any*
17 *payment under the plan, except as provided in regu-*
18 *lations by the Secretary.*

19 *“(4) ELECTIONS.—*

20 *“(A) IN GENERAL.—The requirements of*
21 *this paragraph are met if the requirements of*
22 *subparagraphs (B) and (C) are met.*

23 *“(B) INITIAL DEFERRAL DECISION.—The*
24 *requirements of this subparagraph are met if the*
25 *plan provides that compensation for services per-*

1 formed during a taxable year may be deferred at
2 the participant's election only if the election to
3 defer such compensation is made during the pre-
4 ceding taxable year or at such other time as pro-
5 vided in regulations. In the case of the first year
6 in which a participant becomes eligible to par-
7 ticipate in the plan, such election may be made
8 with respect to services to be performed subse-
9 quent to the election within 30 days after the
10 date the participant becomes eligible to partici-
11 pate in such plan.

12 “(C) CHANGES IN TIME AND FORM OF DIS-
13 TRIBUTION.—The requirements of this subpara-
14 graph are met if, in the case of a plan which
15 permits under a subsequent election a delay in
16 a payment or a change in the form of pay-
17 ment—

18 “(i) the plan requires that such election
19 may not take effect until at least 12 months
20 after the date on which the election is made,

21 “(ii) in the case an election related to
22 a payment not described in clause (ii), (iii),
23 or (vi) of paragraph (2)(A), the plan re-
24 quires that the first payment with respect to
25 which such election is made be deferred for

1 *a period of not less than 5 years from the*
2 *date such payment would otherwise have*
3 *been made, and*

4 *“(iii) the plan requires that any elec-*
5 *tion related to a payment described in*
6 *paragraph (2)(A)(iv) may not be made less*
7 *than 12 months prior to the date of the first*
8 *scheduled payment under such paragraph.*

9 *“(b) RULES RELATING TO FUNDING.—*

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

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

21 *“(B) at the time transferred if such assets*
22 *are subsequently transferred outside of the*
23 *United States.*

24 *“(2) EMPLOYER’S FINANCIAL HEALTH.—In the*
25 *case of a nonqualified deferred compensation plan,*

1 *there is a transfer of property within the meaning of*
2 *section 83 as of the earlier of—*

3 “(A) *the date on which the plan first pro-*
4 *vides that assets will become restricted to the*
5 *provision of benefits under the plan in connec-*
6 *tion with a change in the employer’s financial*
7 *health, or*

8 “(B) *the date on which assets are so re-*
9 *stricted.*

10 “(3) *INCOME INCLUSION FOR OFFSHORE TRUSTS*
11 *AND EMPLOYER’S FINANCIAL HEALTH.—For each tax-*
12 *able year that assets treated as transferred under this*
13 *subsection remain set aside in a trust or other ar-*
14 *rangement subject to paragraph (1) or (2), any in-*
15 *crease in value in, or earnings with respect to, such*
16 *assets shall be treated as an additional transfer of*
17 *property under this subsection (to the extent not pre-*
18 *viously included in income).*

19 “(4) *INTEREST ON TAX LIABILITY PAYABLE WITH*
20 *RESPECT TO TRANSFERRED PROPERTY.—*

21 “(A) *IN GENERAL.—If amounts are re-*
22 *quired to be included in gross income by reason*
23 *of paragraph (1) or (2) for a taxable year, the*
24 *tax imposed by this chapter for such taxable year*

1 *shall be increased by the amount of interest de-*
2 *termined under subparagraph (B).*

3 “(B) *INTEREST.—The interest determined*
4 *under this subparagraph for any taxable year is*
5 *the amount of interest at the underpayment rate*
6 *plus 1 percentage point on the underpayments*
7 *that would have occurred had the amounts so re-*
8 *quired to be included in gross income by para-*
9 *graph (1) or (2) been includible in gross income*
10 *for the taxable year in which such assets were*
11 *first set aside (directly or indirectly) in a trust*
12 *(or other arrangement determined by the Sec-*
13 *retary) for purposes of the nonqualified deferred*
14 *compensation plan.*

15 “(c) *NO INFERENCE ON EARLIER INCOME INCLUSION*
16 *OR REQUIREMENT OF LATER INCLUSION.—Nothing in this*
17 *section shall be construed to prevent the inclusion of*
18 *amounts in gross income under any other provision of this*
19 *chapter or any other rule of law earlier than the time pro-*
20 *vided in this section. Any amount included in gross income*
21 *under this section shall not be required to be included in*
22 *gross income under any other provision of this chapter or*
23 *any other rule of law later than the time provided in this*
24 *section.*

1 “(d) *OTHER DEFINITIONS AND SPECIAL RULES.*—For
2 *purposes of this section—*

3 “(1) *NONQUALIFIED DEFERRED COMPENSATION*
4 *PLAN.*—The term ‘nonqualified deferred compensation
5 *plan*’ means any plan that provides for the deferral
6 *of compensation, other than—*

7 “(A) *a qualified employer plan, and*

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

11 “(2) *QUALIFIED EMPLOYER PLAN.*—The term
12 ‘qualified employer plan’ means—

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

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

19 “(3) *PLAN INCLUDES ARRANGEMENTS, ETC.*—The
20 *term ‘plan’ includes any agreement or arrangement,*
21 *including an agreement or arrangement that includes*
22 *one person.*

23 “(4) *SUBSTANTIAL RISK OF FORFEITURE.*—The
24 *rights of a person to compensation are subject to a*
25 *substantial risk of forfeiture if such person’s rights to*

1 *such compensation are conditioned upon the future*
2 *performance of substantial services by any individual.*

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

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

11 “(1) *providing for the determination of amounts*
12 *of deferral in the case of a nonqualified deferred com-*
13 *penetration plan which is a defined benefit plan,*

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

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

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

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

4 **(b) W-2 FORMS.—**

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

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

14 **(2) THRESHOLD.—***Subsection (a) of section 6051*
15 *is amended by adding at the end the following: “In*
16 *the case of the amounts required to be shown by para-*
17 *graph (12), the Secretary (by regulation) may estab-*
18 *lish a minimum amount of deferrals below which*
19 *paragraph (12) does not apply and may provide that*
20 *paragraph (12) does not apply with respect to*
21 *amounts of deferrals which are not reasonably ascer-*
22 *tainable.*”.

23 **(c) CONFORMING AND CLERICAL AMENDMENTS.—**

24 **(1)** *Section 414(b) is amended by inserting*
25 *“409A,” after “408(p),”.*

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

3 (3) *The table of sections for such subpart A of*
4 *part I of subchapter D of chapter 1 is amended by*
5 *adding at the end the following new item:*

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

6 (d) *EFFECTIVE DATE.—*

7 (1) *IN GENERAL.—Except as otherwise provided*
8 *in this subsection, the amendments made by this sec-*
9 *tion shall apply to amounts deferred in taxable years*
10 *beginning after December 31, 2003.*

11 (2) *AMOUNTS DEFERRED IN 2004 UNDER CERTAIN*
12 *IRREVOCABLE ELECTIONS AND BINDING ARRANGE-*
13 *MENTS.—The amendments made by this section shall*
14 *not apply to amounts deferred in taxable years begin-*
15 *ning after December 31, 2003, and before January 1,*
16 *2005, pursuant to an irrevocable election or binding*
17 *arrangement made before October 24, 2003.*

18 (3) *EARNINGS ATTRIBUTABLE TO AMOUNT PRE-*
19 *VIOUSLY DEFERRED.—The amendments made by this*
20 *section shall apply to earnings on deferred compensa-*
21 *tion only to the extent that such amendments apply*
22 *to such compensation.*

23 (e) *GUIDANCE RELATING TO CHANGE OF OWNERSHIP*
24 *OR CONTROL.—Not later than 90 days after the date of the*

1 *enactment of this Act, the Secretary of the Treasury shall*
2 *issue guidance on what constitutes a change in ownership*
3 *or effective control for purposes of section 409A of the Inter-*
4 *nal Revenue Code of 1986, as added by this section.*

5 (f) *GUIDANCE RELATING TO TERMINATION OF CER-*
6 *TAIN EXISTING ARRANGEMENTS.*—*Not later than 90 days*
7 *after the date of the enactment of this Act, the Secretary*
8 *of the Treasury shall issue guidance providing a limited*
9 *period during which an individual participating in a non-*
10 *qualified deferred compensation plan adopted on or before*
11 *December 31, 2003, may, without violating the require-*
12 *ments of paragraphs (2), (3), and (4) of section 409A(a)(2)*
13 *of the Internal Revenue Code of 1986 (as added by this sec-*
14 *tion), terminate participation or cancel an outstanding de-*
15 *ferred election with regard to amounts earned after Decem-*
16 *ber 31, 2003, if such amounts are includible in income as*
17 *earned.*

18 **SEC. 1062. EXCLUSION OF INCENTIVE STOCK OPTIONS AND**
19 **EMPLOYEE STOCK PURCHASE PLAN STOCK**
20 **OPTIONS FROM WAGES.**

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

22 (1) *SOCIAL SECURITY TAXES.*—

23 (A) *Section 3121(a) (relating to definition*
24 *of wages) is amended by striking “or” at the end*
25 *of paragraph (20), by striking the period at the*

1 *end of paragraph (21) and inserting “; or”, and*
2 *by inserting after paragraph (21) the following*
3 *new paragraph:*

4 “(22) remuneration on account of—

5 “(A) a transfer of a share of stock to any
6 individual pursuant to an exercise of an incen-
7 tive stock option (as defined in section 422(b)) or
8 under an employee stock purchase plan (as de-
9 fined in section 423(b)), or

10 “(B) any disposition by the individual of
11 such stock.”.

12 (B) Section 209(a) of the Social Security
13 Act is amended by striking “or” at the end of
14 paragraph (17), by striking the period at the end
15 of paragraph (18) and inserting “; or”, and by
16 inserting after paragraph (18) the following new
17 paragraph:

18 “(19) Remuneration on account of—

19 “(A) a transfer of a share of stock to any
20 individual pursuant to an exercise of an incen-
21 tive stock option (as defined in section 422(b) of
22 the Internal Revenue Code of 1986) or under an
23 employee stock purchase plan (as defined in sec-
24 tion 423(b) of such Code), or

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

3 (2) *RAILROAD RETIREMENT TAXES.*—Subsection
4 (e) of section 3231 is amended by adding at the end
5 the following new paragraph:

6 “(11) *QUALIFIED STOCK OPTIONS.*—The term
7 ‘compensation’ shall not include any remuneration on
8 account of—

9 “(A) a transfer of a share of stock to any
10 individual pursuant to an exercise of an incen-
11 tive stock option (as defined in section 422(b)) or
12 under an employee stock purchase plan (as de-
13 fined in section 423(b)), or

14 “(B) any disposition by the individual of
15 such stock.”.

16 (3) *UNEMPLOYMENT TAXES.*—Section 3306(b)
17 (relating to definition of wages) is amended by strik-
18 ing “or” at the end of paragraph (16), by striking the
19 period at the end of paragraph (17) and inserting “;
20 or”, and by inserting after paragraph (17) the fol-
21 lowing new paragraph:

22 “(18) remuneration on account of—

23 “(A) a transfer of a share of stock to any
24 individual pursuant to an exercise of an incen-
25 tive stock option (as defined in section 422(b)) or

1 under an employee stock purchase plan (as de-
2 fined in section 423(b)), or

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

5 (b) *WAGE WITHHOLDING NOT REQUIRED ON DIS-*
6 *QUALIFYING DISPOSITIONS.*—Section 421(b) (relating to ef-
7 *fect of disqualifying dispositions)* is amended by adding at
8 *the end the following new sentence: “No amount shall be*
9 *required to be deducted and withheld under chapter 24 with*
10 *respect to any increase in income attributable to a disposi-*
11 *tion described in the preceding sentence.”.*

12 (c) *WAGE WITHHOLDING NOT REQUIRED ON COM-*
13 *PENSATION WHERE OPTION PRICE IS BETWEEN 85 PER-*
14 *CENT AND 100 PERCENT OF VALUE OF STOCK.*—Section
15 *423(c) (relating to special rule where option price is be-*
16 *tween 85 percent and 100 percent of value of stock)* is
17 *amended by adding at the end the following new sentence:*
18 *“No amount shall be required to be deducted and withheld*
19 *under chapter 24 with respect to any amount treated as*
20 *compensation under this subsection.”.*

21 (d) *EFFECTIVE DATE.*—*The amendments made by this*
22 *section shall apply to stock acquired pursuant to options*
23 *exercised after the date of the enactment of this Act.*

1 **SEC. 1063. 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 in-*
5 *serting “December 31, 2013”.*

6 ***Subtitle G—Treatment of Active***
7 ***Income***

8 **SEC. 1071. MEMBER STATES OF THE EUROPEAN UNION**
9 **TREATED AS A SINGLE COUNTRY FOR CER-**
10 **TAIN PURPOSES.**

11 *(a) IN GENERAL.—Subsection (d) of section 954 is*
12 *amended by adding at the end the following new paragraph:*

13 *“(5) TREATMENT OF MEMBER STATES OF THE*
14 *EUROPEAN UNION.—For purposes of this subsection*
15 *and subsection (e), in the case of a controlled foreign*
16 *corporation which is created or organized under the*
17 *laws of a member state of the European Union, all*
18 *member states of the European Union shall be treated*
19 *as 1 country.”.*

20 *(b) EFFECTIVE DATE.—The amendment made by this*
21 *section shall apply to taxable years of foreign corporations*
22 *beginning after December 31, 2008, and to taxable years*
23 *of United States shareholders with or within which such*
24 *taxable years of foreign corporations end.*

1 **SEC. 1072. LOOK-THRU TREATMENT OF PAYMENTS BE-**
2 **TWEEN RELATED CONTROLLED FOREIGN**
3 **CORPORATIONS UNDER FOREIGN PERSONAL**
4 **HOLDING COMPANY INCOME RULES.**

5 (a) *IN GENERAL.*—Subsection (c) of section 954 is
6 amended by adding after paragraph (3) the following new
7 paragraph:

8 “(4) *LOOK-THRU IN THE CASE OF RELATED CON-*
9 *TROLLED FOREIGN CORPORATIONS.*—For purposes of
10 *this subsection, dividends, interest, rents, and royal-*
11 *ties received or accrued from a controlled foreign cor-*
12 *poration which is a related person (as defined in sub-*
13 *section (d)(3)) shall not be treated as foreign personal*
14 *holding company income to the extent attributable or*
15 *properly allocable (determined under rules similar to*
16 *the rules of subparagraphs (C) and (D) of section*
17 *904(d)(3)) to income of the related person which is*
18 *not subpart F income (as defined in section 952). The*
19 *Secretary shall prescribe such regulations as may be*
20 *appropriate to prevent the abuse of the purposes of*
21 *this paragraph.*”

22 (b) *EFFECTIVE DATE.*—The amendments made by this
23 section shall apply to taxable years of foreign corporations
24 beginning after December 31, 2006, and to taxable years
25 of United States shareholders with or within which such
26 taxable years of foreign corporations end.

1 **SEC. 1073. LOOK-THRU TREATMENT FOR SALES OF PART-**
2 **nership INTERESTS.**

3 (a) *IN GENERAL.*—Section 954(c) (defining foreign
4 personal holding company income) is amended by adding
5 after paragraph (4) the following new paragraph:

6 “(5) *LOOK-THRU RULE FOR CERTAIN PARTNER-*
7 *SHIP SALES.*—

8 “(A) *IN GENERAL.*—In the case of any sale
9 by a controlled foreign corporation of an interest
10 in a partnership with respect to which such cor-
11 poration is a 25-percent owner, such corporation
12 shall be treated for purposes of this subsection as
13 selling the proportionate share of the assets of the
14 partnership attributable to such interest.

15 “(B) *25-PERCENT OWNER.*—For purposes of
16 this paragraph, the term ‘25-percent owner’
17 means a controlled foreign corporation which
18 owns (within the meaning of section 958(a)) 25
19 percent or more of the capital or profits interest
20 in the partnership.”

21 (b) *EFFECTIVE DATE.*—The amendments made by this
22 section shall apply to taxable years of foreign corporations
23 beginning after December 31, 2006, and to taxable years
24 of United States shareholders with or within which such
25 taxable years of foreign corporations end.

1 **SEC. 1074. REPEAL OF FOREIGN PERSONAL HOLDING COM-**
2 **PANY RULES AND FOREIGN INVESTMENT**
3 **COMPANY RULES.**

4 (a) *GENERAL RULE.*—*The following provisions are*
5 *hereby repealed:*

6 (1) *Part III of subchapter G of chapter 1 (relat-*
7 *ing to foreign personal holding companies).*

8 (2) *Section 1246 (relating to gain on foreign in-*
9 *vestment company stock).*

10 (3) *Section 1247 (relating to election by foreign*
11 *investment companies to distribute income currently).*

12 (b) *EXEMPTION OF FOREIGN CORPORATIONS FROM*
13 *PERSONAL HOLDING COMPANY RULES.*—

14 (1) *IN GENERAL.*—*Subsection (c) of section 542*
15 *(relating to exceptions) is amended—*

16 (A) *by striking paragraph (5) and inserting*
17 *the following:*

18 “(5) *a foreign corporation,*”

19 (B) *by striking paragraphs (7) and (10)*
20 *and by redesignating paragraphs (8) and (9) as*
21 *paragraphs (7) and (8), respectively,*

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

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

1 (2) *TREATMENT OF INCOME FROM PERSONAL*
2 *SERVICE CONTRACTS.*—Paragraph (1) of section
3 954(c) is amended by adding at the end the following
4 *new subparagraph:*

5 “(H) *PERSONAL SERVICE CONTRACTS.*—

6 “(i) *Amounts received under a contract*
7 *under which the corporation is to furnish*
8 *personal services if—*

9 “(I) *some person other than the*
10 *corporation has the right to designate*
11 *(by name or by description) the indi-*
12 *vidual who is to perform the services,*
13 *or*

14 “(II) *the individual who is to per-*
15 *form the services is designated (by*
16 *name or by description) in the con-*
17 *tract, and*

18 “(ii) *amounts received from the sale or*
19 *other disposition of such a contract.*

20 *This subparagraph shall apply with respect to*
21 *amounts received for services under a particular*
22 *contract only if at some time during the taxable*
23 *year 25 percent or more in value of the out-*
24 *standing stock of the corporation is owned, di-*
25 *rectly or indirectly, by or for the individual who*

1 *has performed, is to perform, or may be des-*
2 *ignated (by name or by description) as the one*
3 *to perform, such services.”*

4 *(c) CONFORMING AMENDMENTS.—*

5 *(1) Clause (iii) of section 1(h)(11)(C) is amended*
6 *by striking “a foreign personal holding company (as*
7 *defined in section 552), a foreign investment company*
8 *(as defined in section 1246(b)), or”.*

9 *(2) Paragraph (2) of section 171(c) is amend-*
10 *ed—*

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

14 *(B) by striking “or foreign personal holding*
15 *company”.*

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

18 *(4) Section 312 is amended by striking sub-*
19 *section (j).*

20 *(5) Subsection (m) of section 312 is amended by*
21 *striking “, a foreign investment company (within the*
22 *meaning of section 1246(b)), or a foreign personal*
23 *holding company (within the meaning of section*
24 *552)”.*

1 (6) *Subsection (e) of section 443 is amended by*
2 *striking paragraph (3) and by redesignating para-*
3 *graphs (4) and (5) as paragraphs (3) and (4), respec-*
4 *tively.*

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

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

14 (9) *Paragraph (1) of section 562(b) is amended*
15 *by striking “or a foreign personal holding company*
16 *described in section 552”.*

17 (10) *Section 563 is amended—*

18 (A) *by striking subsection (c),*

19 (B) *by redesignating subsection (d) as sub-*
20 *section (c), and*

21 (C) *by striking “subsection (a), (b), or (c)”*
22 *in subsection (c) (as so redesignated) and insert-*
23 *ing “subsection (a) or (b)”.*

24 (11) *Subsection (d) of section 751 is amended by*
25 *adding “and” at the end of paragraph (2), by strik-*

1 *ing paragraph (3), by redesignating paragraph (4) as*
2 *paragraph (3), and by striking “paragraph (1), (2),*
3 *or (3)” in paragraph (3) (as so redesignated) and in-*
4 *serting “paragraph (1) or (2)”.*

5 *(12) Paragraph (2) of section 864(d) is amended*
6 *by striking subparagraph (A) and by redesignating*
7 *subparagraphs (B) and (C) as subparagraphs (A)*
8 *and (B), respectively.*

9 *(13)(A) Subparagraph (A) of section 898(b)(1) is*
10 *amended to read as follows:*

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

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

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

19 *“(3) UNITED STATES SHAREHOLDER.—The term*
20 *‘United States shareholder’ has the meaning given to*
21 *such term by section 951(b), except that, in the case*
22 *of a foreign corporation having related person insur-*
23 *ance income (as defined in section 953(c)(2)), the Sec-*
24 *retary may treat any person as a United States*
25 *shareholder for purposes of this section if such person*

1 *is treated as a United States shareholder under sec-*
2 *tion 953(c)(1).”*

3 *(D) Subsection (c) of section 898 is amended to*
4 *read as follows:*

5 *“(c) DETERMINATION OF REQUIRED YEAR.—*

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

7 *“(A) the majority U.S. shareholder year, or*

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

11 *“(2) 1-MONTH DEFERRAL ALLOWED.—A specified*
12 *foreign corporation may elect, in lieu of the taxable*
13 *year under paragraph (1)(A), a taxable year begin-*
14 *ning 1 month earlier than the majority U.S. share-*
15 *holder year.*

16 *“(3) MAJORITY U.S. SHAREHOLDER YEAR.—*

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

22 *“(i) each United States shareholder de-*
23 *scribed in subsection (b)(2)(A), and*

24 *“(ii) each United States shareholder*
25 *not described in clause (i) whose stock was*

1 *treated as owned under subsection (b)(2)(B)*
2 *by any shareholder described in such clause.*

3 “(B) *TESTING DAY.*—*The testing days shall*
4 *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 prescribe.”*

10 (14) *Clause (ii) of section 904(d)(2)(A) is*
11 *amended to read as follows:*

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

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

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

4 (16) *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 (17) *Paragraph (3) of section 989(b) is amended*
8 *by striking “, 551(a),”.*

9 (18) *Paragraph (5) of section 1014(b) is amend-*
10 *ed by inserting “and before January 1, 2008,” after*
11 *“August 26, 1937,”.*

12 (19) *Subsection (a) of section 1016 is amended*
13 *by striking paragraph (13).*

14 (20)(A) *Paragraph (3) of section 1212(a) is*
15 *amended to read as follows:*

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

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

21 *“(B) for which it is a real estate investment*
22 *trust (as defined in section 856).”*

23 (B) *The amendment made by subparagraph (A)*
24 *shall apply to taxable years beginning after December*
25 *31, 2006.*

1 (21) Section 1223 is amended by striking para-
2 graph (10) and by redesignating the following para-
3 graphs accordingly.

4 (22) Subsection (d) of section 1248 is amended
5 by striking paragraph (5) and by redesignating para-
6 graphs (6) and (7) as paragraphs (5) and (6), respec-
7 tively.

8 (23) Paragraph (2) of section 1260(c) is amend-
9 ed by striking subparagraphs (H) and (I) and by re-
10 designating subparagraph (J) as subparagraph (H).

11 (24)(A) Subparagraph (F) of section 1291(b)(3)
12 is amended by striking “551(d), 959(a),” and insert-
13 ing “959(a)”.

14 (B) Subsection (e) of section 1291 is amended by
15 inserting “(as in effect on the day before the date of
16 the enactment of the American Jobs Creation Act of
17 2003)” after “section 1246”.

18 (25) Paragraph (2) of section 1294(a) is amend-
19 ed 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 PFIC
24 earnings tax liability attributable to a qualified elect-
25 ing fund for the taxable year if any amount is in-

1 *cludible in the gross income of the taxpayer under sec-*
2 *tion 951 with respect to such fund for such taxable*
3 *year.”*

4 (26) *Section 6035 is hereby repealed.*

5 (27) *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 (28) *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 951(a),*
14 *the tax may be assessed, or a proceeding in court*
15 *for the collection of such tax may be done with-*
16 *out assessing, at any time within 6 years after*
17 *the return was filed.”*

18 (29) *Subsection (a) of section 6679 is amended—*

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

22 (B) *by striking paragraph (3).*

23 (30) *Sections 170(f)(10)(A), 508(d), 4947, and*
24 *4948(c)(4) are each amended by striking “556(b)(2),”*
25 *each place it appears.*

1 (31) *The table of parts for subchapter G of chap-*
2 *ter 1 is amended by striking the item relating to part*
3 *III.*

4 (32) *The table of sections for part IV of sub-*
5 *chapter P of chapter 1 is amended by striking the*
6 *items relating to sections 1246 and 1247.*

7 (33) *The table of sections for subpart A of part*
8 *III of subchapter A of chapter 61 is amended by strik-*
9 *ing the item relating to section 6035.*

10 (34) *Sections 163(e)(3)(B)(i) and*
11 *267(a)(3)(B)(i) are each amended by—*

12 (A) *striking “a foreign personal holding*
13 *company (as defined in section 552),” and*

14 (B) *striking the comma after “(as defined*
15 *in section 957)”.*

16 (d) *EFFECTIVE DATE.—Except as otherwise provided*
17 *in this section, the amendments made by this section shall*
18 *apply to taxable years of foreign corporations beginning*
19 *after December 31, 2006, and to taxable years of United*
20 *States shareholders with or within which such taxable years*
21 *of foreign corporations end.*

22 **SEC. 1075. CLARIFICATION OF TREATMENT OF PIPELINE**
23 **TRANSPORTATION INCOME.**

24 (a) *IN GENERAL.—Section 954(g)(1) (defining foreign*
25 *base company oil related income) is amended by striking*

1 “or” at the end of subparagraph (A), by striking the period
2 at the end of subparagraph (B) and inserting “, or”, and
3 by inserting after subparagraph (B) the following new sub-
4 paragraph:

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

7 (b) *EFFECTIVE DATE.*—The amendments made by this
8 section shall apply to taxable years of foreign corporations
9 beginning after December 31, 2004, and to taxable years
10 of United States shareholders with or within which such
11 taxable years of foreign corporations end.

12 **SEC. 1076. DETERMINATION OF FOREIGN PERSONAL HOLD-**
13 **ING COMPANY INCOME WITH RESPECT TO**
14 **TRANSACTIONS IN COMMODITIES.**

15 (a) *IN GENERAL.*—Clauses (i) and (ii) of section
16 954(c)(1)(C) (relating to commodity transactions) are
17 amended to read as follows:

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

21 “(ii) are active business gains or losses
22 from the sale of commodities, but only if
23 substantially all of the controlled foreign
24 corporation’s commodities are property de-

1 scribed in paragraph (1), (2), or (8) of sec-
2 tion 1221(a), or”.

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

6 “(6) *DEFINITION AND SPECIAL RULES RELATING*
7 *TO COMMODITY TRANSACTIONS.*—

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

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

15 “(I) without regard to subpara-
16 graph (A)(ii) thereof,

17 “(II) by applying subparagraph
18 (A)(i) thereof by substituting ‘ordinary
19 property or property described in sec-
20 tion 1231(b)’ for ‘ordinary property’,
21 and

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

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

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

8 (c) EFFECTIVE DATE.—The amendments made by this
9 section shall apply to transactions entered into after Decem-
10 ber 31, 2004.

11 **SEC. 1077. REPEAL OF CFC RULES ON FOREIGN BASE COM-**
12 **PANY SHIPPING INCOME.**

13 (a) ELIMINATION OF FOREIGN BASE COMPANY SHIP-
14 PING INCOME.—Section 954 (relating to foreign base com-
15 pany income) is amended—

16 (1) by striking paragraph (4) of subsection (a)
17 (relating to foreign base company shipping income),
18 and

19 (2) by striking subsection (f) (relating to foreign
20 base company shipping income).

21 (b) SAFE HARBOR FOR CERTAIN LEASING ACTIVI-
22 TIES.—Subparagraph (A) of section 954(c)(2) is amended
23 by adding at the end the following new sentence: “For pur-
24 poses of the preceding sentence, rents derived from leasing
25 an aircraft or vessel in foreign commerce shall not fail to

1 *be treated as derived in the active conduct of a trade or*
2 *business if, as determined under regulations prescribed by*
3 *the Secretary, the active leasing expenses are not less than*
4 *10 percent of the profit on the lease.”*

5 *(c) CONFORMING AMENDMENTS.—*

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

10 *(2) Subsection (b) of section 954 is amended—*

11 *(A) by striking “the foreign base company*
12 *shipping income,” in paragraph (5),*

13 *(B) by striking paragraphs (6) and (7), and*

14 *(C) by redesignating paragraph (8) as*
15 *paragraph (6).*

16 *(d) EFFECTIVE DATE.—The amendments made by this*
17 *section shall apply to taxable years of foreign corporations*
18 *beginning after December 31, 2004, and to taxable years*
19 *of United States shareholders with or within which such*
20 *taxable years of foreign corporations end.*

21 **SEC. 1078. MODIFICATION OF SUBPART F EXEMPTION FOR**
22 **ACTIVE FINANCING.**

23 *(a) IN GENERAL.—Section 954(h)(3) is amended by*
24 *adding at the end the following:*

1 “(E) *DIRECT CONDUCT OF ACTIVITIES.*—
2 *For purposes of subparagraph (A)(ii)(II), an ac-*
3 *tivity shall be treated as conducted directly by*
4 *an eligible controlled foreign corporation or*
5 *qualified business unit in its home country if the*
6 *activity is performed by employees of a related*
7 *person and—*

8 “(i) *the related person is an eligible*
9 *controlled foreign corporation the home*
10 *country of which is the same as the home*
11 *country of the corporation or unit to which*
12 *subparagraph (A)(ii)(II) is being applied,*

13 “(ii) *the activity is performed in the*
14 *home country of the related person, and*

15 “(iii) *the related person is compensated*
16 *on an arm’s-length basis for the perform-*
17 *ance of the activity by its employees and*
18 *such compensation is treated as earned by*
19 *such person in its home country for pur-*
20 *poses of the home country’s tax laws.”.*

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

1 **SEC. 1079. PARTIAL EXCLUSION FOR INCOME ATTRIB-**
 2 **UTABLE TO FILMS USED OUTSIDE THE**
 3 **UNITED STATES.**

4 (a) *IN GENERAL.*—Part III of subchapter B of chapter
 5 1 (relating to items specifically excluded from gross income)
 6 is amended by inserting after section 139 the following new
 7 section:

8 **“SEC. 139A. INCOME ATTRIBUTABLE TO FILMS USED OUT-**
 9 **SIDE THE UNITED STATES.**

10 “(a) *EXCLUSION.*—

11 “(1) *IN GENERAL.*—There shall be excluded from
 12 gross income an amount equal to the applicable per-
 13 centage of qualified film income.

14 “(2) *APPLICABLE PERCENTAGE.*—For purposes
 15 of paragraph (1), the applicable percentage shall be
 16 determined in accordance with the following table:

“For taxable years ending in calendar year—	The applicable percentage is—
2007	1
2008	2
2009	3
2010	5
2011	8
2012	9
2013 or thereafter	10.

17 “(b) *QUALIFIED FILM INCOME.*—For purposes of this
 18 section—

19 “(1) *IN GENERAL.*—The term ‘qualified film in-
 20 come’ means gross income from a license of a quali-
 21 fied film in the ordinary course of a trade or business

1 *for the exploitation or direct use outside the United*
2 *States less any associated film costs.*

3 “(2) *EXCEPTIONS.*—

4 “(A) *CERTAIN USES.*—*Such term does not*
5 *include exploitation of characters, soundtracks,*
6 *designs, scripts, scores, or any other ancillary in-*
7 *tangibles associated with the qualified film.*

8 “(B) *RELATED PERSON LICENSE.*—

9 “(i) *IN GENERAL.*—*Such term does not*
10 *include any amount from the license of a*
11 *qualified film to a related person.*

12 “(ii) *EXCEPTION.*—*Clause (i) shall not*
13 *apply if such film is held for license by such*
14 *related person to an unrelated person for*
15 *the direct use or exploitation by such unre-*
16 *lated person outside the United States.*

17 “(iii) *RELATED PERSON.*—*For pur-*
18 *poses of this subparagraph, a person shall*
19 *be related to another person if such persons*
20 *are treated as a single employer under sub-*
21 *section (a) or (b) of section 52 or subsection*
22 *(m) or (o) of section 414, except that deter-*
23 *minations under subsections (a) and (b) of*
24 *section 52 shall be made without regard to*
25 *section 1563(b).*

1 “(c) *OTHER DEFINITIONS.*—*For purposes of this sec-*
2 *tion—*

3 “(1) *QUALIFIED FILM.*—*The term ‘qualified*
4 *film’ means property described in section 168(f)(3)*
5 *the original use of which commences after December*
6 *31, 2006, if not less than 50 percent of the total com-*
7 *penensation relating to the production of such property*
8 *is compensation for services performed in the United*
9 *States by actors, production personnel, directors, and*
10 *producers. Such term does not include property with*
11 *respect to which records are required to be main-*
12 *tained under section 2257 of title 18, United States*
13 *Code.*

14 “(2) *ASSOCIATED FILM COSTS.*—*The term ‘asso-*
15 *ciated film costs’ means any expense properly appor-*
16 *tioned and allocated to income taken into account*
17 *under subsection (b)(1), determined as provided under*
18 *regulations prescribed by the Secretary.*

19 “(d) *ELECTION.*—*The taxpayer may elect not to apply*
20 *this section to a qualified film. Such election shall be made*
21 *by the due date (including extensions of time) for filing the*
22 *return for the taxable year in which such film is placed*
23 *in service, and, once made for such film, such election shall*
24 *be irrevocable.*

25 “(e) *DENIAL OF FOREIGN TAX CREDIT.*—

1 “(1) *IN GENERAL.*—No credit shall be allowed
2 under section 901 for any taxes paid or accrued (or
3 treated as paid or accrued) with respect to the exclud-
4 able portion of any qualified film income. No deduc-
5 tion shall be allowed under this chapter for any tax
6 for which credit is not allowable by reason of the pre-
7 ceding sentence.

8 “(2) *EXCLUDABLE PORTION.*—For purposes of
9 paragraph (1), the taxes paid or accrued (or treated
10 as paid or accrued) with respect to the excludable por-
11 tion is the amount which bears the same ratio to the
12 amount of taxes paid or accrued (or treated as paid
13 or accrued) with respect to qualified film income as
14 the amount excluded under subsection (a) for the tax-
15 able year bears to the qualified film income for such
16 year.”.

17 (b) *CLERICAL AMENDMENT.*—The table of sections for
18 part III of subchapter B of chapter 1 is amended by insert-
19 ing after the item relating to section 139 the following new
20 item:

“Sec. 139A. Income attributable to films used outside the United
States.”.

21 (c) *EFFECTIVE DATE.*—The amendments made by this
22 section shall apply to taxable years ending after December
23 31, 2006.

1 ***Subtitle H—Reduction of Double***
2 ***Taxation of Earnings***

3 ***SEC. 1081. INTEREST EXPENSE ALLOCATION RULES.***

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

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

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

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

19 “(B) *TREATMENT OF WORLDWIDE AFFILI-*
20 *ATED GROUP.*—The taxable income of the domes-
21 tic members of a worldwide affiliated group from
22 sources outside the United States shall be deter-
23 mined by allocating and apportioning the inter-
24 est expense of such domestic members to such in-

1 *come in an amount equal to the excess (if any)*
2 *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 this*
15 *subsection were applied to a group con-*
16 *sisting of all the foreign corporations in*
17 *such worldwide affiliated group.*

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

21 *“(i) the includible members of an af-*
22 *filiated group (as defined in section*
23 *1504(a), determined without regard to*
24 *paragraphs (2) and (4) of section 1504(b)),*
25 *and*

1 “(ii) all controlled foreign corporations
2 in which such members in the aggregate
3 meet the ownership requirements of section
4 1504(a)(2) either directly or indirectly
5 through applying paragraph (2) of section
6 958(a) or through applying rules similar to
7 the rules of such paragraph to stock owned
8 directly or indirectly by domestic partner-
9 ships, trusts, or estates.

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

19 “(3) TREATMENT OF TAX-EXEMPT ASSETS; BASIS
20 OF STOCK IN NONAFFILIATED 10-PERCENT OWNED
21 CORPORATIONS.—The rules of paragraphs (3) and (4)
22 of subsection (e) shall apply for purposes of this sub-
23 section; except that paragraph (4) shall be applied on
24 worldwide affiliated group basis.

1 “(4) *TREATMENT OF CERTAIN FINANCIAL INSTI-*
2 *TUTIONS.—*

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

9 “(B) *DESCRIPTION.—A corporation is de-*
10 *scribed in this subparagraph if—*

11 “(i) *such corporation is a financial in-*
12 *stitution described in section 581 or 591,*

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

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

22 “(C) *TREATMENT OF BANK HOLDING COM-*
23 *PANIES.—To the extent provided in regula-*
24 *tions—*

1 “(i) a bank holding company (within
2 the meaning of section 2(a) of the Bank
3 Holding Company Act of 1956 (12 U.S.C.
4 1841(a)),

5 “(ii) a financial holding company
6 (within the meaning of section 2(p) of such
7 Act), and

8 “(iii) any subsidiary of a financial in-
9 stitution described in section 581 or 591, or
10 any such bank or financial holding com-
11 pany, if such subsidiary is predominantly
12 engaged (directly or indirectly) in the active
13 conduct of a banking, financing, or similar
14 business,

15 shall be treated as a corporation described in
16 subparagraph (B).

17 “(5) *ELECTION TO EXPAND FINANCIAL INSTITU-*
18 *TION GROUP OF WORLDWIDE GROUP.—*

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

22 “(i) are members of such worldwide af-
23 filiated group, but

24 “(ii) are not corporations described in
25 paragraph (4)(B),

1 *shall be treated as described in paragraph (4)(B)*
2 *for purposes of applying paragraph (4)(A). This*
3 *subsection (other than this paragraph) shall*
4 *apply to any such group in the same manner as*
5 *this subsection (other than this paragraph) ap-*
6 *plies to the pre-election worldwide affiliated*
7 *group of which such group is a part.*

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

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

1 “(i) distributes dividends or makes
2 other distributions with respect to its stock
3 after the date of the enactment of this para-
4 graph to any member of the pre-election
5 worldwide affiliated group (other than to a
6 member of the electing financial institution
7 group) in excess of the greater of—

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

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

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

21 an amount of indebtedness of the electing finan-
22 cial institution group equal to the excess dis-
23 tribution or the understatement or overstatement
24 of income, as the case may be, shall be re-
25 characterized (for the taxable year and subse-

1 quent taxable years) for purposes of this para-
2 graph as indebtedness of the worldwide affiliated
3 group (excluding the electing financial institu-
4 tion group). If a corporation has not been in ex-
5 istence for 5 taxable years, this subparagraph
6 shall be applied with respect to the period it was
7 in existence.

8 “(D) *ELECTION*.—An election under this
9 paragraph with respect to any financial institu-
10 tion group may be made only by the common
11 parent of the pre-election worldwide affiliated
12 group and may be made only for the first taxable
13 year beginning after December 31, 2008, in
14 which such affiliated group includes 1 or more
15 financial corporations. Such an election, once
16 made, shall apply to all financial corporations
17 which are members of the electing financial in-
18 stitution group for such taxable year and all
19 subsequent years unless revoked with the consent
20 of the Secretary.

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

23 “(i) *PRE-ELECTION WORLDWIDE AF-*
24 *FILIATED GROUP*.—The term ‘pre-election
25 worldwide affiliated group’ means, with re-

1 *spect to a corporation, the worldwide affili-*
2 *ated group of which such corporation would*
3 *(but for an election under this paragraph)*
4 *be a member for purposes of applying para-*
5 *graph (1).*

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

14 “(F) *REGULATIONS.—The Secretary shall*
15 *prescribe such regulations as may be appropriate*
16 *to carry out this subsection, including regula-*
17 *tions—*

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

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

1 “(iii) dealing with changes in members
2 of any group (through acquisitions or other-
3 wise) treated under this paragraph as an
4 affiliated group for purposes of this sub-
5 section.

6 “(6) *ELECTION*.—An election to have this sub-
7 section apply with respect to any worldwide affiliated
8 group may be made only by the common parent of the
9 domestic affiliated group referred to in paragraph
10 (1)(C) and may be made only for the first taxable
11 year beginning after December 31, 2008, in which a
12 worldwide affiliated group exists which includes such
13 affiliated group and at least one foreign corporation.
14 Such an election, once made, shall apply to such com-
15 mon parent and all other corporations which are
16 members of such worldwide affiliated group for such
17 taxable year and all subsequent years unless revoked
18 with the consent of the Secretary.”.

19 (b) *EXPANSION OF REGULATORY AUTHORITY*.—Para-
20 graph (7) of section 864(e) is amended—

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

1 (2) by striking “and” at the end of subpara-
2 graph (E), by redesignating subparagraph (F) as sub-
3 paragraph (G), and by inserting after subparagraph
4 (E) the following new subparagraph:

5 “(F) preventing assets or interest expense
6 from being taken into account more than once,
7 and”.

8 (c) *EFFECTIVE DATE.*—The amendments made by this
9 section shall apply to taxable years beginning after Decem-
10 ber 31, 2008.

11 **SEC. 1082. RECHARACTERIZATION OF OVERALL DOMESTIC**
12 **LOSS.**

13 (a) *GENERAL RULE.*—Section 904 is amended by re-
14 designating subsections (g), (h), (i), (j), and (k) as sub-
15 sections (h), (i), (j), (k), and (l) respectively, and by insert-
16 ing after subsection (f) the following new subsection:

17 “(g) *RECHARACTERIZATION OF OVERALL DOMESTIC*
18 *LOSS.*—

19 “(1) *GENERAL RULE.*—For purposes of this sub-
20 part and section 936, in the case of any taxpayer who
21 sustains an overall domestic loss for any taxable year
22 beginning after December 31, 2005, that portion of
23 the taxpayer’s taxable income from sources within the
24 United States for each succeeding taxable year which
25 is equal to the lesser of—

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

4 “(B) *50 percent of the taxpayer’s taxable*
5 *income from sources within the United States for*
6 *such succeeding taxable year,*

7 *shall be treated as income from sources without the*
8 *United States (and not as income from sources within*
9 *the United States).*

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

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

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

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

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

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

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

24 (b) *CONFORMING AMENDMENTS.*—

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

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

6 (c) *EFFECTIVE DATE.—The amendments made by this*
7 *section shall apply to losses sustained for taxable years be-*
8 *ginning after December 31, 2005.*

9 **SEC. 1083. REDUCTION TO 2 FOREIGN TAX CREDIT BAS-**
10 **KETS.**

11 (a) *IN GENERAL.—Paragraph (1) of section 904(d)*
12 *(relating to separate application of section with respect to*
13 *certain categories of income) is amended to read as follows:*

14 *“(1) IN GENERAL.—The provisions of subsections*
15 *(a), (b), and (c) and sections 902, 907, and 960 shall*
16 *be applied separately with respect to—*

17 *“(A) passive category income, and*

18 *“(B) general category income.”*

19 (b) *CATEGORIES.—Paragraph (2) of section 904(d) is*
20 *amended by striking subparagraph (B), by redesignating*
21 *subparagraph (A) as subparagraph (B), and by inserting*
22 *before subparagraph (B) (as so redesignated) the following*
23 *new subparagraph:*

24 *“(A) CATEGORIES.—*

1 “(i) *PASSIVE CATEGORY INCOME.*—*The*
2 *term ‘passive category income’ means pas-*
3 *sive income and specified passive category*
4 *income.*”

5 “(ii) *GENERAL CATEGORY INCOME.*—
6 *The term ‘general category income’ means*
7 *income other than passive category income.”*

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

11 “(v) *SPECIFIED PASSIVE CATEGORY IN-*
12 *COME.*—*The term ‘specified passive category*
13 *income’ means—*

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

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

22 “(III) *distributions from a FSC*
23 *(or a former FSC) out of earnings and*
24 *profits attributable to foreign trade in-*
25 *come (within the meaning of section*

1 923(b)) or interest or carrying charges
2 (as defined in section 927(d)(1)) de-
3 rived from a transaction which results
4 in foreign trade income (as defined in
5 section 923(b)).”

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

11 “(C) *TREATMENT OF FINANCIAL SERVICES*
12 *INCOME AND COMPANIES.*—

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

16 “(I) a member of a financial serv-
17 ices group, and

18 “(II) any other person if such per-
19 son is predominantly engaged in the
20 active conduct of a banking, insurance,
21 financing, or similar business.

22 “(ii) *FINANCIAL SERVICES GROUP.*—
23 The term ‘financial services group’ means
24 any affiliated group (as defined in section
25 1504(a) without regard to paragraphs (2)

1 and (3) of section 1504(b)) which is pre-
2 dominantly engaged in the active conduct of
3 a banking, insurance, financing, or similar
4 business. In determining whether such a
5 group is so engaged, there shall be taken
6 into account only the income of members of
7 the group that are—

8 “(I) United States corporations,

9 or

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

15 “(iii) *PASS-THRU ENTITIES.*—The Sec-
16 retary shall by regulation specify for pur-
17 poses of this subparagraph the treatment of
18 financial services income received or ac-
19 crued by partnerships and by other pass-
20 thru entities which are not members of a fi-
21 nancial services group.”

22 (e) *CONFORMING AMENDMENTS.*—

23 (1) Clause (iii) of section 904(d)(2)(B) (relating
24 to exceptions from passive income), as so redesign-
25 ated, is amended by striking subclause (I) and by

1 *redesignating subclauses (II) and (III) as subclauses*
2 *(I) and (II), respectively.*

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

8 *“(II) passive income (determined*
9 *without regard to subparagraph*
10 *(B)(iii)(II)).”*

11 *(3) Section 904(d)(2)(D) (defining financial*
12 *services income), as so redesignated, is amended by*
13 *striking clause (iii).*

14 *(4) Paragraph (3) of section 904(d) is amended*
15 *to read as follows:*

16 *“(3) LOOK-THRU IN CASE OF CONTROLLED FOR-*
17 *EIGN CORPORATIONS.—*

18 *“(A) IN GENERAL.—Except as otherwise*
19 *provided in this paragraph, dividends, interest,*
20 *rents, and royalties received or accrued by the*
21 *taxpayer from a controlled foreign corporation*
22 *in which the taxpayer is a United States share-*
23 *holder shall not be treated as passive category in-*
24 *come.*

1 “(B) *SUBPART F INCLUSIONS.*—*Any*
2 *amount included in gross income under section*
3 *951(a)(1)(A) shall be treated as passive category*
4 *income to the extent the amount so included is*
5 *attributable to passive category income.*

6 “(C) *INTEREST, RENTS, AND ROYALTIES.*—
7 *Any interest, rent, or royalty which is received*
8 *or accrued from a controlled foreign corporation*
9 *in which the taxpayer is a United States share-*
10 *holder shall be treated as passive category in-*
11 *come to the extent it is properly allocable (under*
12 *regulations prescribed by the Secretary) to pas-*
13 *sive category income of the controlled foreign cor-*
14 *poration.*

15 “(D) *DIVIDENDS.*—*Any dividend paid out*
16 *of the earnings and profits of any controlled for-*
17 *ign corporation in which the taxpayer is a*
18 *United States shareholder shall be treated as pas-*
19 *sive category income in proportion to the ratio*
20 *of—*

21 “(i) *the portion of the earnings and*
22 *profits attributable to passive category in-*
23 *come, to*

24 “(ii) *the total amount of earnings and*
25 *profits.*

1 “(E) *LOOK-THRU APPLIES ONLY WHERE*
2 *SUBPART F APPLIES.*—*If a controlled foreign cor-*
3 *poration meets the requirements of section*
4 *954(b)(3)(A) (relating to de minimis rule) for*
5 *any taxable year, for purposes of this paragraph,*
6 *none of its foreign base company income (as de-*
7 *fined in section 954(a) without regard to section*
8 *954(b)(5)) and none of its gross insurance in-*
9 *come (as defined in section 954(b)(3)(C)) for*
10 *such taxable year shall be treated as passive cat-*
11 *egory income, except that this sentence shall not*
12 *apply to any income which (without regard to*
13 *this sentence) would be treated as financial serv-*
14 *ices income. Solely for purposes of applying sub-*
15 *paragraph (D), passive income of a controlled*
16 *foreign corporation shall not be treated as pas-*
17 *sive category income if the requirements of sec-*
18 *tion 954(b)(4) are met with respect to such in-*
19 *come.*

20 “(F) *COORDINATION WITH HIGH-TAXED IN-*
21 *COME PROVISIONS.*—

22 “(i) *In determining whether any in-*
23 *come of a controlled foreign corporation is*
24 *passive category income, subclause (II) of*
25 *paragraph (2)(B)(iii) shall not apply.*

1 “(ii) Any income of the taxpayer
2 which is treated as passive category income
3 under this paragraph shall be so treated
4 notwithstanding any provision of para-
5 graph (2); except that the determination of
6 whether any amount is high-taxed income
7 shall be made after the application of this
8 paragraph.

9 “(G) *DIVIDEND.*—For purposes of this
10 paragraph, the term ‘dividend’ includes any
11 amount included in gross income in section
12 951(a)(1)(B). Any amount included in gross in-
13 come under section 78 to the extent attributable
14 to amounts included in gross income in section
15 951(a)(1)(A) shall not be treated as a dividend
16 but shall be treated as included in gross income
17 under section 951(a)(1)(A).

18 “(H) *LOOK-THRU APPLIES TO PASSIVE FOR-*
19 *EIGN INVESTMENT COMPANY INCLUSION.*—If—

20 “(i) a passive foreign investment com-
21 pany is a controlled foreign corporation,
22 and

23 “(ii) the taxpayer is a United States
24 shareholder in such controlled foreign cor-
25 poration,

1 *any amount included in gross income under sec-*
2 *tion 1293 shall be treated as income in a sepa-*
3 *rate category to the extent such amount is attrib-*
4 *utable to income in such category.”*

5 (5) *TREATMENT OF INCOME TAX BASE DIF-*
6 *FERENCES.—Paragraph (2) of section 904(d) is*
7 *amended by redesignating subparagraphs (H) and (I)*
8 *as subparagraphs (I) and (J), respectively, and by in-*
9 *serting after subparagraph (G) the following new sub-*
10 *paragraph:*

11 “(H) *TREATMENT OF INCOME TAX BASE*
12 *DIFFERENCES.—Tax imposed under the law of a*
13 *foreign country or possession of the United*
14 *States on an amount which does not constitute*
15 *income under United States tax principles shall*
16 *be treated as imposed on income described in*
17 *paragraph (1)(B).”*

18 (6) *Paragraph (2) of section 904(d) is amended*
19 *by adding at the end the following new subparagraph:*

20 “(K) *TRANSITIONAL RULES FOR 2005*
21 *CHANGES.—For purposes of paragraph (1)—*

22 “(i) *taxes carried from any taxable*
23 *year beginning before January 1, 2005, to*
24 *any taxable year beginning on or after such*
25 *date, with respect to any item of income,*

1 *shall be treated as described in the subpara-*
2 *graph of paragraph (1) in which such in-*
3 *come would be described were such taxes*
4 *paid or accrued in a taxable year beginning*
5 *on or after such date, and*

6 “(ii) the Secretary may by regulations
7 provide for the allocation of any carryback
8 of taxes with respect to income to such a
9 taxable year for purposes of allocating such
10 income among the separate categories in ef-
11 fect for such taxable year.”.

12 (7) Section 904(j)(3)(A)(i) is amended by strik-
13 ing “subsection (d)(2)(A)” and inserting “subsection
14 (d)(2)(B)”.

15 (f) *EFFECTIVE DATE.*—The amendments made by this
16 section shall apply to taxable years beginning after Decem-
17 ber 31, 2004.

18 **SEC. 1084. 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 look-
22 thru rules apply to dividends from noncontrolled section
23 902 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 described in a*
5 *subparagraph of paragraph (1) in proportion to*
6 *the ratio of—*

7 “(i) *the portion of earnings and profits*
8 *attributable to income described in such*
9 *subparagraph, to*

10 “(ii) *the total amount of earnings and*
11 *profits.*

12 “(B) *SPECIAL RULES.*—*For purposes of this*
13 *paragraph—*

14 “(i) *EARNINGS AND PROFITS.*—

15 “(I) *IN GENERAL.*—*The rules of*
16 *section 316 shall apply.*

17 “(II) *REGULATIONS.*—*The Sec-*
18 *retary may prescribe regulations re-*
19 *garding the treatment of distributions*
20 *out of earnings and profits for periods*
21 *before the taxpayer’s acquisition of the*
22 *stock to which the distributions relate.*

23 “(ii) *INADEQUATE SUBSTANTIATION.*—
24 *If the Secretary determines that the proper*
25 *subparagraph of paragraph (1) in which a*

1 *dividend is described has not been substan-*
2 *tiated, such dividend shall be treated as in-*
3 *come described in paragraph (1)(A).*

4 “(iii) *LOOK-THRU WITH RESPECT TO*
5 *CARRYFORWARDS OF CREDIT.—Rules simi-*
6 *lar to subparagraph (A) also shall apply to*
7 *any carryforward under subsection (c) from*
8 *a taxable year beginning before January 1,*
9 *2003, of tax allocable to a dividend from a*
10 *noncontrolled section 902 corporation with*
11 *respect to the taxpayer. The Secretary may*
12 *by regulations provide for the allocation of*
13 *any carryback of tax allocable to a dividend*
14 *from a noncontrolled section 902 corpora-*
15 *tion to such a taxable year for purposes of*
16 *allocating such dividend among the separate*
17 *categories in effect for such taxable year.*

18 “(iv) *COORDINATION WITH HIGH-*
19 *TAXED INCOME PROVISIONS.—Rules similar*
20 *to the rules of paragraph (3)(F) shall apply*
21 *for purposes of this paragraph.”.*

22 (b) *CONFORMING AMENDMENTS.—*

23 (1) *Section 904(d)(2)(E) is amended—*

24 (A) *by inserting “or (4)” after “paragraph*
25 (3)” *in clause (i), and*

1 (B) by striking clauses (ii) and (iv) and by
2 redesignating clause (iii) as clause (ii).

3 (2) Clause (i) of section 864(d)(5)(A) is amended
4 to read as follows:

5 “(i) Subclause (I) of section
6 904(d)(2)(B)(iii).”

7 (c) *EFFECTIVE DATE.*—The amendments made by this
8 section shall apply to taxable years beginning after Decem-
9 ber 31, 2002.

10 **SEC. 1085. ATTRIBUTION OF STOCK OWNERSHIP THROUGH**
11 **PARTNERSHIPS TO APPLY IN DETERMINING**
12 **SECTION 902 AND 960 CREDITS.**

13 (a) *IN GENERAL.*—Subsection (c) of section 902 is
14 amended by redesignating paragraph (7) as paragraph (8)
15 and by inserting after paragraph (6) the following new
16 paragraph:

17 “(7) *CONSTRUCTIVE OWNERSHIP THROUGH*
18 *PARTNERSHIPS.*—Stock owned, directly or indirectly,
19 by or for a partnership shall be considered as being
20 owned proportionately by its partners. Stock consid-
21 ered to be owned by a person by reason of the pre-
22 ceding sentence shall, for purposes of applying such
23 sentence, be treated as actually owned by such person.
24 The Secretary may prescribe such regulations as may
25 be necessary to carry out the purposes of this para-

1 *graph, including rules to account for special partner-*
2 *ship allocations of dividends, credits, and other inci-*
3 *dents of ownership of stock in determining propor-*
4 *tionate ownership.”*

5 *(b) CLARIFICATION OF COMPARABLE ATTRIBUTION*
6 *UNDER SECTION 901(b)(5).—Paragraph (5) of section*
7 *901(b) is amended by striking “any individual” and insert-*
8 *ing “any person”.*

9 *(c) EFFECTIVE DATE.—The amendments made by this*
10 *section shall apply to taxes of foreign corporations for tax-*
11 *able years of such corporations beginning after the date of*
12 *the enactment of this Act.*

13 **SEC. 1086. CLARIFICATION OF TREATMENT OF CERTAIN**
14 **TRANSFERS OF INTANGIBLE PROPERTY.**

15 *(a) IN GENERAL.—Subparagraph (C) of section*
16 *367(d)(2) is amended by adding at the end the following*
17 *new sentence: “For purposes of applying section 904(d),*
18 *any such amount shall be treated in the same manner as*
19 *if such amount were a royalty.”*

20 *(b) EFFECTIVE DATE.—The amendment made by this*
21 *section shall apply to amounts treated as received pursuant*
22 *to section 367(d)(2) of the Internal Revenue Code of 1986*
23 *on or after August 5, 1997.*

1 **SEC. 1087. UNITED STATES PROPERTY NOT TO INCLUDE**
2 **CERTAIN ASSETS ACQUIRED BY DEALERS IN**
3 **ORDINARY COURSE OF TRADE OR BUSINESS.**

4 (a) *IN GENERAL.*—Section 956(c)(2) (relating to ex-
5 ceptions from property treated as United States property)
6 is amended by striking “and” at the end of subparagraph
7 (J), by striking the period at the end of subparagraph (K)
8 and inserting “; and”, and by adding at the end the fol-
9 lowing new subparagraph:

10 “(L) securities acquired and held by a con-
11 trolled foreign corporation in the ordinary course
12 of its business as a dealer in securities if—

13 “(i) the dealer accounts for the securi-
14 ties as securities held primarily for sale to
15 customers in the ordinary course of busi-
16 ness, and

17 “(ii) the dealer disposes of the securi-
18 ties (or such securities mature while held by
19 the dealer) within a period consistent with
20 the holding of securities for sale to cus-
21 tomers in the ordinary course of business.”

22 (b) *CONFORMING AMENDMENT.*—Section 956(c)(2) is
23 amended by striking “and (K)” in the last sentence and
24 inserting “, (K), and (L)”.

25 (c) *EFFECTIVE DATE.*—The amendments made by this
26 section shall apply to taxable years of foreign corporations

1 *beginning after December 31, 2004, and to taxable years*
2 *of United States shareholders with or within which such*
3 *taxable years of foreign corporations end.*

4 **SEC. 1088. ELECTION NOT TO USE AVERAGE EXCHANGE**
5 **RATE FOR FOREIGN TAX PAID OTHER THAN**
6 **IN FUNCTIONAL CURRENCY.**

7 *(a) IN GENERAL.—Paragraph (1) of section 986(a)*
8 *(relating to determination of foreign taxes and foreign cor-*
9 *poration’s earnings and profits) is amended by redesign-*
10 *ating subparagraph (D) as subparagraph (E) and by in-*
11 *serting after subparagraph (C) the following new subpara-*
12 *graph:*

13 *“(D) ELECTIVE EXCEPTION FOR TAXES*
14 *PAID OTHER THAN IN FUNCTIONAL CURRENCY.—*

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 **SEC. 1090. PROVIDE EQUAL TREATMENT FOR INTEREST**
2 **PAID BY FOREIGN PARTNERSHIPS AND FOR-**
3 **EIGN CORPORATIONS.**

4 (a) *IN GENERAL.*—Paragraph (1) of section 861(a) is
5 amended by striking “and” at the end of subparagraph (A),
6 by striking the period at the end of subparagraph (B) and
7 inserting “, and”, and by adding at the end the following
8 new subparagraph:

9 “(C) in the case of a foreign partnership in
10 which United States persons do not hold directly
11 or indirectly 20 percent or more of either the
12 capital or profits interests, any interest not paid
13 by a trade or business engaged in by the partner-
14 ship in the United States and not allocable to
15 income which is effectively connected (or treated
16 as effectively connected) with the conduct of a
17 trade or business in the United States.”

18 (b) *EFFECTIVE DATE.*—The amendments made by this
19 section shall apply to taxable years beginning after Decem-
20 ber 31, 2003.

21 **SEC. 1091. TREATMENT OF CERTAIN DIVIDENDS OF REGU-**
22 **LATED INVESTMENT COMPANIES.**

23 (a) *TREATMENT OF CERTAIN DIVIDENDS.*—

24 (1) *NONRESIDENT ALIEN INDIVIDUALS.*—Section
25 871 (relating to tax on nonresident alien individuals)
26 is amended by redesignating subsection (k) as sub-

1 *section (l) and by inserting after subsection (j) the fol-*
2 *lowing new subsection:*

3 *“(k) EXEMPTION FOR CERTAIN DIVIDENDS OF REGU-*
4 *LATED INVESTMENT COMPANIES.—*

5 *“(1) INTEREST-RELATED DIVIDENDS.—*

6 *“(A) IN GENERAL.—Except as provided in*
7 *subparagraph (B), no tax shall be imposed under*
8 *paragraph (1)(A) of subsection (a) on any inter-*
9 *est-related dividend received from a regulated in-*
10 *vestment company.*

11 *“(B) EXCEPTIONS.—Subparagraph (A)*
12 *shall not apply—*

13 *“(i) to any interest-related dividend re-*
14 *ceived from a regulated investment com-*
15 *pany by a person to the extent such divi-*
16 *dend is attributable to interest (other than*
17 *interest described in subparagraph (E) (i)*
18 *or (iii)) received by such company on in-*
19 *debtedness issued by such person or by any*
20 *corporation or partnership with respect to*
21 *which such person is a 10-percent share-*
22 *holder,*

23 *“(ii) to any interest-related dividend*
24 *with respect to stock of a regulated invest-*
25 *ment company unless the person who would*

1 otherwise be required to deduct and with-
2 hold tax from such dividend under chapter
3 3 receives a statement (which meets require-
4 ments similar to the requirements of sub-
5 section (h)(5)) that the beneficial owner of
6 such stock is not a United States person,
7 and

8 “(iii) to any interest-related dividend
9 paid to any person within a foreign coun-
10 try (or any interest-related dividend pay-
11 ment addressed to, or for the account of,
12 persons within such foreign country) during
13 any period described in subsection (h)(6)
14 with respect to such country.

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

19 “(C) *INTEREST-RELATED DIVIDEND.*—For
20 purposes of this paragraph, an interest-related
21 dividend is any dividend (or part thereof) which
22 is designated by the regulated investment com-
23 pany as an interest-related dividend in a writ-
24 ten notice mailed to its shareholders not later
25 than 60 days after the close of its taxable year.

1 *If the aggregate amount so designated with re-*
2 *spect to a taxable year of the company (includ-*
3 *ing amounts so designated with respect to divi-*
4 *dends paid after the close of the taxable year de-*
5 *scribed in section 855) is greater than the quali-*
6 *fied net interest income of the company for such*
7 *taxable year, the portion of each distribution*
8 *which shall be an interest-related dividend shall*
9 *be only that portion of the amounts so designated*
10 *which such qualified net interest income bears to*
11 *the aggregate amount so designated.*

12 *“(D) QUALIFIED NET INTEREST INCOME.—*
13 *For purposes of subparagraph (C), the term*
14 *‘qualified net interest income’ means the quali-*
15 *fied interest income of the regulated investment*
16 *company reduced by the deductions properly al-*
17 *locable to such income.*

18 *“(E) QUALIFIED INTEREST INCOME.—For*
19 *purposes of subparagraph (D), the term ‘quali-*
20 *fied interest income’ means the sum of the fol-*
21 *lowing amounts derived by the regulated invest-*
22 *ment company from sources within the United*
23 *States:*

24 *“(i) Any amount includible in gross*
25 *income as original issue discount (within*

1 *the meaning of section 1273) on an obliga-*
2 *tion payable 183 days or less from the date*
3 *of original issue (without regard to the pe-*
4 *riod held by the company).*

5 “(ii) *Any interest includible in gross*
6 *income (including amounts recognized as*
7 *ordinary income in respect of original issue*
8 *discount or market discount or acquisition*
9 *discount under part V of subchapter P and*
10 *such other amounts as regulations may pro-*
11 *vide) on an obligation which is in registered*
12 *form; except that this clause shall not apply*
13 *to—*

14 “(I) *any interest on an obligation*
15 *issued by a corporation or partnership*
16 *if the regulated investment company is*
17 *a 10-percent shareholder in such cor-*
18 *poration or partnership, and*

19 “(II) *any interest which is treated*
20 *as not being portfolio interest under*
21 *the rules of subsection (h)(4).*

22 “(iii) *Any interest referred to in sub-*
23 *section (i)(2)(A) (without regard to the*
24 *trade or business of the regulated investment*
25 *company).*

1 “(iv) *Any interest-related dividend in-*
2 *cludable in gross income with respect to*
3 *stock of another regulated investment com-*
4 *pany.*

5 “(F) *10-PERCENT SHAREHOLDER.—For*
6 *purposes of this paragraph, the term ‘10-percent*
7 *shareholder’ has the meaning given such term by*
8 *subsection (h)(3)(B).*

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

10 “(A) *IN GENERAL.—Except as provided in*
11 *subparagraph (B), no tax shall be imposed under*
12 *paragraph (1)(A) of subsection (a) on any short-*
13 *term capital gain dividend received from a regu-*
14 *lated investment company.*

15 “(B) *EXCEPTION FOR ALIENS TAXABLE*
16 *UNDER SUBSECTION (a)(2).—Subparagraph (A)*
17 *shall not apply in the case of any nonresident*
18 *alien individual subject to tax under subsection*
19 *(a)(2).*

20 “(C) *SHORT-TERM CAPITAL GAIN DIVI-*
21 *DEND.—For purposes of this paragraph, a short-*
22 *term capital gain dividend is any dividend (or*
23 *part thereof) which is designated by the regu-*
24 *lated investment company as a short-term cap-*
25 *ital gain dividend in a written notice mailed to*

1 *its shareholders not later than 60 days after the*
2 *close of its taxable year. If the aggregate amount*
3 *so designated with respect to a taxable year of*
4 *the company (including amounts so designated*
5 *with respect to dividends paid after the close of*
6 *the taxable year described in section 855) is*
7 *greater than the qualified short-term gain of the*
8 *company for such taxable year, the portion of*
9 *each distribution which shall be a short-term*
10 *capital gain dividend shall be only that portion*
11 *of the amounts so designated which such quali-*
12 *fied short-term gain bears to the aggregate*
13 *amount so designated.*

14 *“(D) QUALIFIED SHORT-TERM GAIN.—For*
15 *purposes of subparagraph (C), the term ‘quali-*
16 *fied short-term gain’ means the excess of the net*
17 *short-term capital gain of the regulated invest-*
18 *ment company for the taxable year over the net*
19 *long-term capital loss (if any) of such company*
20 *for such taxable year. For purposes of this sub-*
21 *paragraph—*

22 *“(i) the net short-term capital gain of*
23 *the regulated investment company shall be*
24 *computed by treating any short-term cap-*
25 *ital gain dividend includible in gross in-*

1 *come with respect to stock of another regu-*
2 *lated investment company as a short-term*
3 *capital gain, and*

4 “(ii) *the excess of the net short-term*
5 *capital gain for a taxable year over the net*
6 *long-term capital loss for a taxable year (to*
7 *which an election under section 4982(e)(4)*
8 *does not apply) shall be determined without*
9 *regard to any net capital loss or net short-*
10 *term capital loss attributable to trans-*
11 *actions after October 31 of such year, and*
12 *any such net capital loss or net short-term*
13 *capital loss shall be treated as arising on*
14 *the 1st day of the next taxable year.*

15 *To the extent provided in regulations, clause (ii)*
16 *shall apply also for purposes of computing the*
17 *taxable income of the regulated investment com-*
18 *pany.”*

19 (2) *FOREIGN CORPORATIONS.—Section 881 (re-*
20 *lating to tax on income of foreign corporations not*
21 *connected with United States business) is amended by*
22 *redesignating subsection (e) as subsection (f) and by*
23 *inserting after subsection (d) the following new sub-*
24 *section:*

1 “(e) *TAX NOT TO APPLY TO CERTAIN DIVIDENDS OF*
2 *REGULATED INVESTMENT COMPANIES.*—

3 “(1) *INTEREST-RELATED DIVIDENDS.*—

4 “(A) *IN GENERAL.*—*Except as provided in*
5 *subparagraph (B), no tax shall be imposed under*
6 *paragraph (1) of subsection (a) on any interest-*
7 *related dividend (as defined in section 871(k)(1))*
8 *received from a regulated investment company.*

9 “(B) *EXCEPTION.*—*Subparagraph (A) shall*
10 *not apply—*

11 “(i) *to any dividend referred to in sec-*
12 *tion 871(k)(1)(B), and*

13 “(ii) *to any interest-related dividend*
14 *received by a controlled foreign corporation*
15 *(within the meaning of section 957(a)) to*
16 *the extent such dividend is attributable to*
17 *interest received by the regulated investment*
18 *company from a person who is a related*
19 *person (within the meaning of section*
20 *864(d)(4)) with respect to such controlled*
21 *foreign corporation.*

22 “(C) *TREATMENT OF DIVIDENDS RECEIVED*
23 *BY CONTROLLED FOREIGN CORPORATIONS.*—*The*
24 *rules of subsection (c)(5)(A) shall apply to any*
25 *interest-related dividend received by a controlled*

1 *foreign corporation (within the meaning of sec-*
2 *tion 957(a)) to the extent such dividend is attrib-*
3 *utable to interest received by the regulated in-*
4 *vestment company which is described in clause*
5 *(ii) of section 871(k)(1)(E) (and not described in*
6 *clause (i) or (iii) of such section).*

7 “(2) *SHORT-TERM CAPITAL GAIN DIVIDENDS.—*
8 *No tax shall be imposed under paragraph (1) of sub-*
9 *section (a) on any short-term capital gain dividend*
10 *(as defined in section 871(k)(2)) received from a regu-*
11 *lated investment company.”*

12 (3) *WITHHOLDING TAXES.—*

13 (A) *Section 1441(c) (relating to exceptions)*
14 *is amended by adding at the end the following*
15 *new paragraph:*

16 “(12) *CERTAIN DIVIDENDS RECEIVED FROM REG-*
17 *ULATED INVESTMENT COMPANIES.—*

18 (A) *IN GENERAL.—No tax shall be re-*
19 *quired to be deducted and withheld under sub-*
20 *section (a) from any amount exempt from the*
21 *tax imposed by section 871(a)(1)(A) by reason of*
22 *section 871(k).*

23 (B) *SPECIAL RULE.—For purposes of sub-*
24 *paragraph (A), clause (i) of section 871(k)(1)(B)*
25 *shall not apply to any dividend unless the regu-*

1 *lated investment company knows that such divi-*
2 *divend is a dividend referred to in such clause. A*
3 *similar rule shall apply with respect to the ex-*
4 *ception contained in section 871(k)(2)(B).”*

5 *(B) Section 1442(a) (relating to with-*
6 *holding of tax on foreign corporations) is amend-*
7 *ed—*

8 *(i) by striking “and the reference in*
9 *section 1441(c)(10)” and inserting “the ref-*
10 *erence 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 2105*
24 *(relating to property without the United States for estate*

1 *tax purposes) is amended by adding at the end the following*
2 *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 (as*
6 *defined in section 851) owned by a nonresident not*
7 *a citizen of the United States shall not be deemed*
8 *property within the United States in the proportion*
9 *that, at the end of the quarter of such investment*
10 *company’s taxable year immediately preceding a de-*
11 *cedent’s date of death (or at such other time as the*
12 *Secretary may designate in regulations), the assets of*
13 *the investment company that were qualifying assets*
14 *with respect to the decedent bore to the total assets of*
15 *the investment company.*

16 “(2) *QUALIFYING ASSETS.*—*For purposes of this*
17 *subsection, qualifying assets with respect to a dece-*
18 *dent are assets that, if owned directly by the decedent,*
19 *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 COMPANIES UNDER SECTION 897.*—

3 (1) *Paragraph (1) of section 897(h) is amended by striking “REIT” each place it appears and inserting “qualified investment entity”.*

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

8 “(2) *SALE OF STOCK IN DOMESTICALLY CONTROLLED ENTITY NOT TAXED.*—*The term ‘United States real property interest’ does not include any interest in a domestically controlled qualified investment entity.*

13 “(3) *DISTRIBUTIONS BY DOMESTICALLY CONTROLLED QUALIFIED INVESTMENT ENTITIES.*—*In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.*”

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

21 “(A) *QUALIFIED INVESTMENT ENTITY.*—*The term ‘qualified investment entity’ means any real estate investment trust and any regulated 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” and*
10 *inserting “qualified investment entity”.*

11 (5) *The subsection heading for subsection (h) of*
12 *section 897 is amended by striking “REITS” and in-*
13 *serting “CERTAIN INVESTMENT ENTITIES”.*

14 (d) *EFFECTIVE DATE.*—

15 (1) *IN GENERAL.*—*Except as otherwise provided*
16 *in this subsection, the amendments made by this sec-*
17 *tion shall apply to dividends with respect to taxable*
18 *years of regulated investment companies beginning*
19 *after the date of the enactment of this Act.*

20 (2) *ESTATE TAX TREATMENT.*—*The amendment*
21 *made by subsection (b) shall apply to estates of dece-*
22 *dents dying after the date of the enactment of this*
23 *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 enact-
2 ment of this Act.

3 **Subtitle I—Other Provisions**

4 **SEC. 1101. SPECIAL RULES FOR LIVESTOCK SOLD ON AC-** 5 **COUNT OF WEATHER-RELATED CONDITIONS.**

6 (a) *RULES FOR REPLACEMENT OF INVOLUNTARILY*
7 *CONVERTED LIVESTOCK.—Subsection (e) of section 1033*
8 *(relating to involuntary conversions) is amended—*

9 (1) *by striking “CONDITIONS.—For purposes”*
10 *and inserting “CONDITIONS.—*

11 *“(1) IN GENERAL.—For purposes”, and*

12 *(2) by adding at the end the following new para-*
13 *graph:*

14 *“(2) EXTENSION OF REPLACEMENT PERIOD.—*

15 *“(A) IN GENERAL.—In the case of drought,*
16 *flood, or other weather-related conditions de-*
17 *scribed in paragraph (1) which result in the*
18 *area being designated as eligible for assistance*
19 *by the Federal Government, subsection (a)(2)(B)*
20 *shall be applied with respect to any converted*
21 *property by substituting ‘4 years’ for ‘2 years’.*

22 *“(B) FURTHER EXTENSION BY SEC-*
23 *RETARY.—The Secretary may extend on a re-*
24 *gional basis the period for replacement under*
25 *this section (after the application of subpara-*

1 *graph (A)) for such additional time as the Sec-*
2 *retary determines appropriate if the weather-re-*
3 *lated conditions which resulted in such applica-*
4 *tion continue for more than 3 years.”.*

5 **(b) INCOME INCLUSION RULES.**—*Subsection (e) of sec-*
6 *tion 451 (relating to special rule for proceeds from livestock*
7 *sold on account of drought, flood, or other weather-related*
8 *conditions) is amended by adding at the end the following*
9 *new paragraph:*

10 *“(3) SPECIAL ELECTION RULES.—If section*
11 *1033(e)(2) applies to a sale or exchange of livestock*
12 *described in paragraph (1), the election under para-*
13 *graph (1) shall be deemed valid if made during the*
14 *replacement period described in such section.”.*

15 **(c) EFFECTIVE DATE.**—*The amendments made by this*
16 *section shall apply to any taxable year with respect to*
17 *which the due date (without regard to extensions) for the*
18 *return is after December 31, 2002.*

19 **SEC. 1102. PAYMENT OF DIVIDENDS ON STOCK OF CO-**
20 **OPERATIVES WITHOUT REDUCING PATRON-**
21 **AGE DIVIDENDS.**

22 **(a) IN GENERAL.**—*Subsection (a) of section 1388 (re-*
23 *lating to patronage dividend defined) is amended by adding*
24 *at the end the following: “For purposes of paragraph (3),*
25 *net earnings shall not be reduced by amounts paid during*

1 *the year as dividends on capital stock or other proprietary*
 2 *capital interests of the organization to the extent that the*
 3 *articles of incorporation or bylaws of such organization or*
 4 *other contract with patrons provide that such dividends are*
 5 *in addition to amounts otherwise payable to patrons which*
 6 *are derived from business done with or for patrons during*
 7 *the taxable year.”.*

8 **(b) EFFECTIVE DATE.**—*The amendment made by this*
 9 *section shall apply to distributions in taxable years begin-*
 10 *ning after the date of the enactment of this Act.*

11 **SEC. 1103. VACCINE TAX TO APPLY TO HEPATITIS A VAC-**
 12 **CINE.**

13 **(a) IN GENERAL.**—*Paragraph (1) of section 4132(a)*
 14 *(defining taxable vaccine) is amended by redesignating sub-*
 15 *paragraphs (I), (J), (K), and (L) as subparagraphs (J),*
 16 *(K), (L), and (M), respectively, and by inserting after sub-*
 17 *paragraph (H) the following new subparagraph:*

18 *“(I) Any vaccine against hepatitis A.”*

19 **(b) EFFECTIVE DATE.**—

20 **(1) SALES, ETC.**—*The amendments made by sub-*
 21 *section (a) shall apply to sales and uses on or after*
 22 *the first day of the first month which begins more*
 23 *than 4 weeks after the date of the enactment of this*
 24 *Act.*

1 (2) *DELIVERIES.*—For purposes of paragraph
2 (1) and section 4131 of the Internal Revenue Code of
3 1986, in the case of sales on or before the effective date
4 described in such paragraph for which delivery is
5 made after such date, the delivery date shall be con-
6 sidered the sale date.

7 **SEC. 1104. EXPANSION OF HUMAN CLINICAL TRIALS QUALI-**
8 **FYING FOR ORPHAN DRUG CREDIT.**

9 (a) *IN GENERAL.*—Paragraph (2) of section 45C(b)
10 (relating to qualified clinical testing expenses) is amended
11 by adding at the end the following new subparagraph:

12 “(C) *TREATMENT OF CERTAIN EXPENSES*
13 *INCURRED BEFORE DESIGNATION.*—For purposes
14 of subparagraph (A)(ii)(I), if a drug is des-
15 ignated under section 526 of the Federal Food,
16 Drug, and Cosmetic Act not later than the due
17 date (including extensions) for filing the return
18 of tax under this subtitle for the taxable year in
19 which the application for such designation of
20 such drug was filed, such drug shall be treated
21 as having been designated on the date that such
22 application was filed.”.

23 (b) *EFFECTIVE DATE.*—The amendment made by sub-
24 section (a) shall apply to expenses incurred after the date
25 of the enactment of this Act.

1 **SEC. 1105. DISTRIBUTIONS FROM PUBLICLY TRADED PART-**
2 **NERSHIPS TREATED AS QUALIFYING INCOME**
3 **OF REGULATED INVESTMENT COMPANIES.**

4 (a) *IN GENERAL.*—Paragraph (2) of section 851(b)
5 (defining regulated investment company) is amended to
6 read as follows:

7 “(2) at least 90 percent of its gross income is de-
8 rived from—

9 “(A) dividends, interest, payments with re-
10 spect to securities loans (as defined in section
11 512(a)(5)), and gains from the sale or other dis-
12 position of stock or securities (as defined in sec-
13 tion 2(a)(36) of the Investment Company Act of
14 1940, as amended) or foreign currencies, or other
15 income (including but not limited to gains from
16 options, futures or forward contracts) derived
17 with respect to its business of investing in such
18 stock, securities, or currencies, and

19 “(B) distributions or other income derived
20 from an interest in a qualified publicly traded
21 partnership (as defined in subsection (h)); and”.

22 (b) *SOURCE FLOW-THROUGH RULE NOT TO APPLY.*—
23 The last sentence of section 851(b) is amended by inserting
24 “(other than a qualified publicly traded partnership as de-
25 fined in subsection (h))” after “derived from a partner-
26 ship”.

1 (c) *LIMITATION ON OWNERSHIP.*—Subsection (c) of
2 section 851 is amended by redesignating paragraph (5) as
3 paragraph (6) and inserting after paragraph (4) the fol-
4 lowing new paragraph:

5 “(5) The term ‘outstanding voting securities of
6 such issuer’ shall include the equity securities of a
7 qualified publicly traded partnership (as defined in
8 subsection (h)).”.

9 (d) *DEFINITION OF QUALIFIED PUBLICLY TRADED*
10 *PARTNERSHIP.*—Section 851 is amended by adding at the
11 end the following new subsection:

12 “(h) *QUALIFIED PUBLICLY TRADED PARTNERSHIP.*—
13 For purposes of this section, the term ‘qualified publicly
14 traded partnership’ means a publicly traded partnership
15 described in section 7704(b) other than a partnership which
16 would satisfy the gross income requirements of section
17 7704(c)(2) if qualifying income included only income de-
18 scribed in subsection (b)(2)(A).”.

19 (e) *DEFINITION OF QUALIFYING INCOME.*—Section
20 7704(d)(4) is amended by striking “section 851(b)(2)” and
21 inserting “section 851(b)(2)(A)”.

22 (f) *LIMITATION ON COMPOSITION OF ASSETS.*—Sub-
23 paragraph (B) of section 851(b)(3) is amended to read as
24 follows:

1 “(B) not more than 25 percent of the value
2 of its total assets is invested in—

3 “(i) the securities (other than Govern-
4 ment securities or the securities of other reg-
5 ulated investment companies) of any one
6 issuer,

7 “(ii) the securities (other than the secu-
8 rities of other regulated investment compa-
9 nies) of two or more issuers which the tax-
10 payer controls and which are determined,
11 under regulations prescribed by the Sec-
12 retary, to be engaged in the same or similar
13 trades or businesses or related trades or
14 businesses, or

15 “(iii) the securities of one or more
16 qualified publicly traded partnerships (as
17 defined in subsection (h)).”.

18 (g) *APPLICATION OF SPECIAL PASSIVE ACTIVITY RULE*
19 *TO REGULATED INVESTMENT COMPANIES.*—Subsection (k)
20 of section 469 (relating to separate application of section
21 in case of publicly traded partnerships) is amended by add-
22 ing at the end the following new paragraph:

23 “(4) *APPLICATION TO REGULATED INVESTMENT*
24 *COMPANIES.*—For purposes of this section, a regulated
25 investment company (as defined in section 851) hold-

1 “(B) *Any loan to an individual or an es-*
2 *tate.*

3 “(C) *Any section 467 rental agreement (as*
4 *defined in section 467(d)), other than with a per-*
5 *son described in subsection (d)(2)(B).*

6 “(D) *Any obligation to pay rents from real*
7 *property (as defined in subsection (d)(1)).*

8 “(E) *Any security issued by a State or any*
9 *political subdivision thereof, the District of Co-*
10 *lumbia, a foreign government or any political*
11 *subdivision thereof, or the Commonwealth of*
12 *Puerto Rico, but only if the determination of*
13 *any payment received or accrued under such se-*
14 *curity does not depend in whole or in part on*
15 *the profits of any entity not described in this*
16 *subparagraph or payments on any obligation*
17 *issued by such an entity,*

18 “(F) *Any security issued by a real estate*
19 *investment trust.*

20 “(G) *Any other arrangement as determined*
21 *by the Secretary.*

22 “(2) *SPECIAL RULES RELATING TO STRAIGHT*
23 *DEBT SECURITIES.—*

24 “(A) *IN GENERAL.—For purposes of para-*
25 *graph (1)(A), securities meet the requirements of*

1 *this paragraph if such securities are straight*
2 *debt, as defined in section 1361(c)(5) (without*
3 *regard to subparagraph (B)(iii) thereof).*

4 “(B) *SPECIAL RULES RELATING TO CERTAIN*
5 *CONTINGENCIES.—For purposes of subparagraph*
6 *(A), any interest or principal shall not be treat-*
7 *ed as failing to satisfy section 1361(c)(5)(B)(i)*
8 *solely by reason of the fact that the time of pay-*
9 *ment of such interest or principal is subject to*
10 *a contingency, but only if—*

11 “(i) *any such contingency does not*
12 *have the effect of changing the effective yield*
13 *to maturity, as determined under section*
14 *1272, other than a change in the annual*
15 *yield to maturity which either—*

16 “(I) *does not exceed the greater of*
17 *$\frac{1}{4}$ of 1 percent or 5 percent of the an-*
18 *nual yield to maturity, or*

19 “(II) *results solely from a default*
20 *or the exercise of a prepayment right*
21 *by the issuer of the debt, or*

22 “(ii) *neither the aggregate issue price*
23 *nor the aggregate face amount of the issuer’s*
24 *debt instruments held by the trust exceeds*
25 *\$1,000,000 and not more than 12 months of*

1 *unaccrued interest can be required to be*
2 *prepaid thereunder.*

3 “(C) *SPECIAL RULES RELATING TO COR-*
4 *PORATE OR PARTNERSHIP ISSUERS.—In the case*
5 *of an issuer which is a corporation or a partner-*
6 *ship, securities that otherwise would be described*
7 *in paragraph (1)(A) shall be considered not to be*
8 *so described if the trust holding such securities*
9 *and any of its controlled taxable REIT subsidi-*
10 *aries (as defined in subsection (d)(8)(A)(iv))*
11 *hold any securities of the issuer which—*

12 *“(i) are not described in paragraph (1)*
13 *(prior to the application of this subpara-*
14 *graph), and*

15 *“(ii) have an aggregate value greater*
16 *than 1 percent of the issuer’s outstanding*
17 *securities determined without regard to*
18 *paragraph (3)(A)(i).*

19 “(3) *LOOK-THROUGH RULE FOR PARTNERSHIP*
20 *SECURITIES.—*

21 “(A) *IN GENERAL.—For purposes of apply-*
22 *ing subclause (III) of subsection (c)(4)(B)(iii)—*

23 *“(i) a trust’s interest as a partner in*
24 *a partnership (as defined in section*

1 7701(a)(2)) shall not be considered a secu-
2 rity, and

3 “(ii) the trust shall be deemed to own
4 its proportionate share of each of the assets
5 of the partnership.

6 “(B) DETERMINATION OF TRUST’S INTER-
7 EST IN PARTNERSHIP ASSETS.—For purposes of
8 subparagraph (A), with respect to any taxable
9 year beginning after the date of the enactment of
10 this subparagraph—

11 “(i) the trust’s interest in the partner-
12 ship assets shall be the trust’s proportionate
13 interest in any securities issued by the part-
14 nership (determined without regard to sub-
15 paragraph (A)(i) and paragraph (4), but
16 not including securities described in para-
17 graph (1)), and

18 “(ii) the value of any debt instrument
19 shall be the adjusted issue price thereof, as
20 defined in section 1272(a)(4).

21 “(4) CERTAIN PARTNERSHIP DEBT INSTRUMENTS
22 NOT TREATED AS A SECURITY.—For purposes of ap-
23 plying subclause (III) of subsection (c)(4)(B)(iii)—

24 “(A) any debt instrument issued by a part-
25 nership and not described in paragraph (1) shall

1 *not be considered a security to the extent of the*
2 *trust's interest as a partner in the partnership,*
3 *and*

4 “(B) *any debt instrument issued by a part-*
5 *nership and not described in paragraph (1) shall*
6 *not be considered a security if at least 75 percent*
7 *of the partnership's gross income (excluding*
8 *gross income from prohibited transactions) is de-*
9 *ived from sources referred to in subsection*
10 *(c)(3).*

11 “(5) *SECRETARIAL GUIDANCE.—The Secretary is*
12 *authorized to provide guidance (including through the*
13 *issuance of a written determination, as defined in sec-*
14 *tion 6110(b)) that an arrangement shall not be con-*
15 *sidered a security held by the trust for purposes of ap-*
16 *plying subclause (III) of subsection (c)(4)(B)(iii) not-*
17 *withstanding that such arrangement otherwise could*
18 *be considered a security under subparagraph (F) of*
19 *subsection (c)(5).”.*

20 “(b) *CLARIFICATION OF APPLICATION OF LIMITED*
21 *RENTAL EXCEPTION.—Subparagraph (A) of section*
22 *856(d)(8) (relating to special rules for taxable REIT sub-*
23 *sidaries) is amended to read as follows:*

24 “(A) *LIMITED RENTAL EXCEPTION.—*

1 “(i) *IN GENERAL.*—*The requirements*
2 *of this subparagraph are met with respect*
3 *to any property if at least 90 percent of the*
4 *leased space of the property is rented to per-*
5 *sons other than taxable REIT subsidiaries*
6 *of such trust and other than persons de-*
7 *scribed in paragraph (2)(B).*

8 “(ii) *RENTS MUST BE SUBSTANTIALLY*
9 *COMPARABLE.*—*Clause (i) shall apply only*
10 *to the extent that the amounts paid to the*
11 *trust as rents from real property (as defined*
12 *in paragraph (1) without regard to para-*
13 *graph (2)(B)) from such property are sub-*
14 *stantially comparable to such rents paid by*
15 *the other tenants of the trust’s property for*
16 *comparable space.*

17 “(iii) *TIMES FOR TESTING RENT COM-*
18 *PARABILITY.*—*The substantial com-*
19 *parability requirement of clause (ii) shall be*
20 *treated as met with respect to a lease to a*
21 *taxable REIT subsidiary of the trust if such*
22 *requirement is met under the terms of the*
23 *lease—*

24 “(I) *at the time such lease is en-*
25 *tered into,*

1 “(II) at the time of each extension
2 of the lease, including a failure to exer-
3 cise a right to terminate, and

4 “(III) at the time of any modi-
5 fication of the lease between the trust
6 and the taxable REIT subsidiary if the
7 rent under such lease is effectively in-
8 creased pursuant to such modification.

9 With respect to subclause (III), if the tax-
10 able REIT subsidiary of the trust is a con-
11 trolled taxable REIT subsidiary of the trust,
12 the term ‘rents from real property’ shall not
13 in any event include rent under such lease
14 to the extent of the increase in such rent on
15 account of such modification.

16 “(iv) CONTROLLED TAXABLE REIT
17 SUBSIDIARY.—For purposes of clause (iii),
18 the term ‘controlled taxable REIT sub-
19 sidiary’ means, with respect to any real es-
20 tate investment trust, any taxable REIT
21 subsidiary of such trust if such trust owns
22 directly or indirectly—

23 “(I) stock possessing more than 50
24 percent of the total voting power of the

1 *outstanding stock of such subsidiary,*
2 *or*

3 *“(II) stock having a value of more*
4 *than 50 percent of the total value of the*
5 *outstanding stock of such subsidiary.*

6 *“(v) CONTINUING QUALIFICATION*
7 *BASED ON THIRD PARTY ACTIONS.—If the*
8 *requirements of clause (i) are met at a time*
9 *referred to in clause (iii), such requirements*
10 *shall continue to be treated as met so long*
11 *as there is no increase in the space leased*
12 *to any taxable REIT subsidiary of such*
13 *trust or to any person described in para-*
14 *graph (2)(B).*

15 *“(vi) CORRECTION PERIOD.—If there is*
16 *an increase referred to in clause (v) during*
17 *any calendar quarter with respect to any*
18 *property, the requirements of clause (iii)*
19 *shall be treated as met during the quarter*
20 *and the succeeding quarter if such require-*
21 *ments are met at the close of such suc-*
22 *ceeding quarter.”.*

23 *(c) DELETION OF CUSTOMARY SERVICES EXCEP-*
24 *TION.—Subparagraph (B) of section 857(b)(7) (relating to*
25 *redetermined rents) is amended by striking clause (ii) and*

1 by redesignating clauses (iii), (iv), (v), (vi), and (vii) as
2 clauses (ii), (iii), (iv), (v), and (vi), respectively.

3 (d) *CONFORMITY WITH GENERAL HEDGING DEFINI-*
4 *TION.*—Subparagraph (G) of section 856(c)(5) (relating to
5 treatment of certain hedging instruments) is amended to
6 read as follows:

7 “(G) *TREATMENT OF CERTAIN HEDGING IN-*
8 *STRUMENTS.*—Except to the extent provided by
9 regulations, any income of a real estate invest-
10 ment trust from a hedging transaction (as de-
11 fined in clause (ii) or (iii) of section
12 1221(b)(2)(A)) which is clearly identified pursu-
13 ant to section 1221(a)(7), including gain from
14 the sale or disposition of such a transaction,
15 shall not constitute gross income under para-
16 graph (2) to the extent that the transaction
17 hedges any indebtedness incurred or to be in-
18 curred by the trust to acquire or carry real estate
19 assets.”.

20 (e) *CONFORMITY WITH REGULATED INVESTMENT*
21 *COMPANY RULES.*—Clause (i) of section 857(b)(5)(A) (re-
22 lating to imposition of tax in case of failure to meet certain
23 requirements) is amended by striking “90 percent” and in-
24 serting “95 percent”.

25 (f) *EFFECTIVE DATES.*—

1 (1) *IN GENERAL.*—*Except as provided in para-*
2 *graph (2), the amendments made by this section shall*
3 *apply to taxable years beginning after December 31,*
4 *2000.*

5 (2) *SUBPARAGRAPHS (c) THROUGH (e).*—*The*
6 *amendments made by subsections (c), (d), and (e)*
7 *shall apply to taxable years beginning after the date*
8 *of the enactment of this Act.*

9 **SEC. 1107. SIMPLIFICATION OF EXCISE TAX IMPOSED ON**
10 **BOWS AND ARROWS.**

11 (a) *BOWS.*—*Paragraph (1) of section 4161(b) (relating*
12 *to bows) is amended to read as follows:*

13 “(1) *BOWS.*—

14 “(A) *IN GENERAL.*—*There is hereby im-*
15 *posed on the sale by the manufacturer, producer,*
16 *or importer of any bow which has a peak draw*
17 *weight of 30 pounds or more, a tax equal to 11*
18 *percent of the price for which so sold.*

19 “(B) *ARCHERY EQUIPMENT.*—*There is here-*
20 *by imposed on the sale by the manufacturer, pro-*
21 *ducer, or importer—*

22 “(i) *of any part or accessory suitable*
23 *for inclusion in or attachment to a bow de-*
24 *scribed in subparagraph (A), and*

1 “(ii) of any quiver or broadhead suit-
2 able for use with an arrow described in
3 paragraph (3),
4 a tax equal to 11 percent of the price for which
5 so sold.”.

6 (b) *ARROWS*.—Subsection (b) of section 4161 (relating
7 to bows and arrows, etc.) is amended by redesignating para-
8 graph (3) as paragraph (4) and inserting after paragraph
9 (2) the following:

10 “(3) *ARROWS*.—

11 “(A) *IN GENERAL*.—There is hereby im-
12 posed on the sale by the manufacturer, producer,
13 or importer of any arrow, a tax equal to 12 per-
14 cent of the price for which so sold.

15 “(B) *EXCEPTION*.—The tax imposed by sub-
16 paragraph (A) on an arrow shall not apply if
17 the arrow contains an arrow shaft with respect
18 to which tax was paid under paragraph (2).

19 “(C) *ARROW*.—For purposes of this para-
20 graph, the term ‘arrow’ means any shaft de-
21 scribed in paragraph (2) to which additional
22 components are attached.”.

23 (c) *CONFORMING AMENDMENTS*.—(1) Section
24 4161(b)(2) is amended by inserting “(other than a broad-
25 head)” after “point”.

1 (2) *The heading of section 4161(b)(2) is amended by*
 2 *striking “ARROWS.—” and inserting “ARROW COMPO-*
 3 *NENTS.—”.*

4 (d) *EFFECTIVE DATE.—The amendments made by this*
 5 *section shall apply to articles sold by the manufacturer,*
 6 *producer, or importer after December 31, 2003.*

7 **SEC. 1108. REPEAL OF EXCISE TAX ON FISHING TACKLE**
 8 **BOXES.**

9 (a) *REPEAL.—Paragraph (6) of section 4162(a) (de-*
 10 *fining sport fishing equipment) is amended by striking sub-*
 11 *paragraph (C) and by redesignating subparagraphs (D)*
 12 *through (J) as subparagraphs (C) through (I), respectively.*

13 (b) *EFFECTIVE DATE.—The amendments made this*
 14 *section shall apply to articles sold by the manufacturer,*
 15 *producer, or importer after December 31, 2003.*

16 **SEC. 1109. INCOME TAX CREDIT TO DISTILLED SPIRITS**
 17 **WHOLESALERS FOR COST OF CARRYING FED-**
 18 **ERAL EXCISE TAXES ON BOTTLED DISTILLED**
 19 **SPIRITS.**

20 (a) *IN GENERAL.—Subpart A of part I of subchapter*
 21 *A of chapter 51 (relating to gallonage and occupational*
 22 *taxes) is amended by adding at the end the following new*
 23 *section:*

1 **“SEC. 5011. INCOME TAX CREDIT FOR WHOLESALER’S AVER-**
2 **AGE COST OF CARRYING EXCISE TAX.**

3 *“(a) IN GENERAL.—For purposes of section 38, in the*
4 *case of an eligible wholesaler, the amount of the distilled*
5 *spirits wholesalers credit for any taxable year is the amount*
6 *equal to the product of—*

7 *“(1) the number of cases of bottled distilled spir-*
8 *its—*

9 *“(A) which were bottled in the United*
10 *States, and*

11 *“(B) which are purchased by such whole-*
12 *saler during the taxable year directly from the*
13 *bottler of such spirits, and*

14 *“(2) the average tax-financing cost per case for*
15 *the most recent calendar year ending before the begin-*
16 *ning of such taxable year.*

17 *“(b) ELIGIBLE WHOLESALER.—For purposes of this*
18 *section, the term ‘eligible wholesaler’ means any person who*
19 *holds a permit under the Federal Alcohol Administration*
20 *Act as a wholesaler of distilled spirits.*

21 *“(c) AVERAGE TAX-FINANCING COST.—*

22 *“(1) IN GENERAL.—For purposes of this section,*
23 *the average tax-financing cost per case for any cal-*
24 *endar year is the amount of interest which would ac-*
25 *cruce at the deemed financing rate during a 60-day*

1 *period on an amount equal to the deemed Federal ex-*
2 *cise per case.*

3 “(2) *DEEMED FINANCING RATE.*—*For purposes*
4 *of paragraph (1), the deemed financing rate for any*
5 *calendar year is the average of the corporate overpay-*
6 *ment rates under paragraph (1) of section 6621(a)*
7 *(determined without regard to the last sentence of*
8 *such paragraph) for calendar quarters of such year.*

9 “(3) *DEEMED FEDERAL EXCISE TAX BASED ON*
10 *CASE OF 12 80-PROOF 750ML BOTTLES.*—*For purposes*
11 *of paragraph (1), the deemed Federal excise tax per*
12 *case is \$22.83.*

13 “(4) *NUMBER OF CASES IN LOT.*—*For purposes*
14 *of this section, the number of cases in any lot of dis-*
15 *tilled spirits shall be determined by dividing the*
16 *number of liters in such lot by 9.”*

17 (b) *CONFORMING AMENDMENTS.*—

18 (1) *Subsection (b) of section 38 is amended by*
19 *striking “plus” at the end of paragraph (14), by*
20 *striking the period at the end of paragraph (15) and*
21 *inserting “, plus”, and by adding at the end the fol-*
22 *lowing new paragraph:*

23 “(16) *in the case of an eligible wholesaler (as de-*
24 *finied in section 5011(b)), the distilled spirits whole-*
25 *saler credit determined under section 5011(a).”*

1 (2) *Subsection (d) of section 39 (relating to*
2 *carryback and carryforward of unused credits) is*
3 *amended by adding at the end the following new*
4 *paragraph:*

5 “(11) *NO CARRYBACK OF SECTION 5011 CREDIT*
6 *BEFORE JANUARY 1, 2004.—No portion of the unused*
7 *business credit for any taxable year which is attrib-*
8 *utable to the credit determined under section 5011(a)*
9 *may be carried back to a taxable year beginning be-*
10 *fore January 1, 2004.”.*

11 (3) *The table of sections for subpart A of part I*
12 *of subchapter A of chapter 51 is amended by adding*
13 *at the end the following new item:*

 “*Sec. 5011. Income tax credit for wholesaler’s average cost of car-*
 rying excise tax.”.

14 (c) *EFFECTIVE DATE.—The amendments made by this*
15 *section shall apply to taxable years beginning after Decem-*
16 *ber 31, 2003.*

17 **SEC. 1110. CAPITAL GAIN TREATMENT UNDER SECTION**
18 **631(b) TO APPLY TO OUTRIGHT SALES BY**
19 **LANDOWNERS.**

20 (a) *IN GENERAL.—The first sentence of section 631(b)*
21 *(relating to disposal of timber with a retained economic in-*
22 *terest) is amended by striking “retains an economic interest*
23 *in such timber” and inserting “either retains an economic*

1 *interest in such timber or makes an outright sale of such*
2 *timber”.*

3 (b) *CONFORMING AMENDMENTS.*—

4 (1) *The third sentence of section 631(b) is*
5 *amended by striking “The date of disposal” and in-*
6 *serting “In the case of disposal of timber with a re-*
7 *tained economic interest, the date of disposal”.*

8 (2) *The heading for section 631(b) is amended by*
9 *striking “WITH A RETAINED ECONOMIC INTEREST”.*

10 (c) *EFFECTIVE DATE.*—*The amendments made by this*
11 *section shall apply to sales after December 31, 2003.*

12 **SEC. 1111. SONAR DEVICES SUITABLE FOR FINDING FISH.**

13 (a) *NOT TREATED AS SPORT FISHING EQUIPMENT.*—
14 *Subsection (a) of section 4162 (relating to sport fishing*
15 *equipment defined) is amended by inserting “and” at the*
16 *end of paragraph (8), by striking “, and” at the end of*
17 *paragraph (9) and inserting a period, and by striking*
18 *paragraph (10).*

19 (b) *CONFORMING AMENDMENT.*—*Section 4162 is*
20 *amended by striking subsection (b) and by redesignating*
21 *subsection (c) as subsection (b).*

22 (c) *EFFECTIVE DATE.*—*The amendments made this*
23 *section shall apply to articles sold by the manufacturer,*
24 *producer, or importer after December 31, 2003.*

1 **SEC. 1112. TAXATION OF CERTAIN SETTLEMENT FUNDS.**

2 (a) *IN GENERAL.*—Subsection (g) of section 468B (re-
3 *lating to clarification of taxation of certain funds*) is
4 *amended to read as follows:*

5 “(g) *CLARIFICATION OF TAXATION OF CERTAIN*
6 *FUNDS.*—

7 “(1) *IN GENERAL.*—Except as provided in para-
8 *graph (2), nothing in any provision of law shall be*
9 *construed as providing that an escrow account, settle-*
10 *ment fund, or similar fund is not subject to current*
11 *income tax. The Secretary shall prescribe regulations*
12 *providing for the taxation of any such account or*
13 *fund whether as a grantor trust or otherwise.*

14 “(2) *EXEMPTION FROM TAX FOR CERTAIN SET-*
15 *TLEMENT FUNDS.*—An escrow account, settlement
16 *fund, or similar fund shall be treated as beneficially*
17 *owned by the United States and shall be exempt from*
18 *taxation under this subtitle if—*

19 “(A) *it is established pursuant to a consent*
20 *decree entered by a judge of a United States Dis-*
21 *trict Court,*

22 “(B) *it is created for the receipt of settle-*
23 *ment payments as directed by a government en-*
24 *tity for the sole purpose of resolving or satisfying*
25 *one or more claims asserting liability under the*

1 **“SEC. 5148. SUSPENSION OF OCCUPATIONAL TAX.**

2 “(a) *IN GENERAL.*—Notwithstanding sections 5081,
3 5091, 5111, 5121, and 5131, the rate of tax imposed under
4 such sections for the suspension period shall be zero. During
5 such period, persons engaged in or carrying on a trade or
6 business covered by such sections shall register under section
7 5141 and shall comply with the recordkeeping requirements
8 under this part.

9 “(b) *SUSPENSION PERIOD.*—For purposes of sub-
10 section (a), the suspension period is the period beginning
11 on July 1, 2004, and ending on June 30, 2007.”.

12 “(b) *CONFORMING AMENDMENT.*—Section 5117 is
13 amended by adding at the end the following new subsection:

14 “(d) *SPECIAL RULE DURING SUSPENSION PERIOD.*—
15 Except as provided by the Secretary, during the suspension
16 period (as defined in section 5148) it shall be unlawful for
17 any dealer to purchase distilled spirits for resale from any
18 person other than a wholesale dealer in liquors who is re-
19 quired to keep records under section 5114.”.

20 “(c) *CLERICAL AMENDMENT.*—The table of sections for
21 subpart G of part II of subchapter A of chapter 51 is
22 amended by striking the last item and inserting the fol-
23 lowing new items:

“Sec. 5148. Suspension of occupational tax.

“Sec. 5149. Cross references.”.

1 (d) *EFFECTIVE DATE.*—*The amendments made by this*
 2 *section shall take effect on the date of the enactment of this*
 3 *Act.*

4 **TITLE II—PROVISIONS TO RE-**
 5 **DUCE TAX AVOIDANCE**
 6 **THROUGH CORPORATE EARN-**
 7 **INGS STRIPPING AND EXPA-**
 8 **TRIATION**

9 **SEC. 2001. REDUCTION IN POTENTIAL FOR EARNINGS**
 10 **STRIPPING BY FURTHER LIMITING DEDUC-**
 11 **TION FOR INTEREST ON CERTAIN INDEBTED-**
 12 **NESS.**

13 (a) *REDUCTION IN POTENTIAL FOR EARNINGS STRIP-*
 14 *PING.*—

15 (1) *IN GENERAL.*—*Section 163(j) is amended by*
 16 *striking paragraphs (1) and (2), by redesignating*
 17 *paragraphs (3) through (8) as paragraphs (4)*
 18 *through (9), respectively, and by inserting before*
 19 *paragraph (4), as so redesignated, the following new*
 20 *paragraphs:*

21 “(1) *LIMITATION.*—

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

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

4 “(i) *the corporation’s excess interest ex-*
5 *pense for the taxable year, and*

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

8 *In no event shall the disallowance under sub-*
9 *paragraph (A) reduce the deduction for interest*
10 *below the sum of the amount of interest includ-*
11 *ible in the gross income of the taxpayer for such*
12 *taxable year and an amount equal to 25 percent*
13 *of adjusted taxable income (35 percent in the*
14 *case of the first taxable year beginning after De-*
15 *cember 31, 2003).*

16 “(C) *DISALLOWED AMOUNT CARRIED TO*
17 *SUCCEEDING TAXABLE YEAR.*—

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

1 “(ii) *LIMITATION ON AMOUNT CARRIED*
2 *TO YEAR.*—A carryforward amount may
3 not be taken into account for any such suc-
4 ceeding taxable year to the extent that such
5 amount, when added to amounts carried to
6 such succeeding taxable year from taxable
7 years preceding the taxable year from which
8 the amount is being carried forward, would
9 result in (or increase) a disallowance under
10 subparagraph (A).

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

1 “(2) *EXCESS INTEREST EXPENSE; EXCESS RE-*
2 *LATED PARTY INTEREST EXPENSE.*—*For purposes of*
3 *this subsection—*

4 “(A) *EXCESS INTEREST EXPENSE.*—*The*
5 *term ‘excess interest expense’ means the excess (if*
6 *any) of—*

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

9 “(ii) *50 percent of the adjusted taxable*
10 *income of the corporation.*

11 “(B) *EXCESS RELATED PARTY INTEREST*
12 *EXPENSE.*—*The term ‘excess related party inter-*
13 *est expense’ means the excess (if any) of—*

14 “(i) *the lesser of—*

15 “(I) *the amount of disqualified*
16 *interest described in paragraph (3)(A),*
17 *or*

18 “(II) *the corporation’s net interest*
19 *expense, over*

20 “(ii) *25 percent (35 percent in the case*
21 *of the first taxable year beginning after De-*
22 *cember 31, 2003) of the adjusted taxable in-*
23 *come of the corporation.*

24 “(3) *ALTERNATIVE MAXIMUM DISALLOWANCE.*—

1 “(A) *IN GENERAL.*—*In the case of a cor-*
2 *poration with respect to which an election is in*
3 *effect under subparagraph (B), the amount dis-*
4 *allowed under paragraph (1)(A) shall not exceed*
5 *the excess (if any) of—*

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

8 “(ii) *30 percent of the adjusted taxable*
9 *income of the corporation.*

10 “(B) *ELECTION.*—*A corporation may make*
11 *a one-time irrevocable election to have the alter-*
12 *native maximum disallowance described in sub-*
13 *paragraph (A) apply for purposes of this sub-*
14 *section in lieu of paragraph (1)(B). An election*
15 *under this subparagraph shall not apply with re-*
16 *spect to any taxable year beginning before Janu-*
17 *ary 1, 2005.*

18 “(C) *LIMITATION.*—*Subparagraph (B) shall*
19 *not apply with respect to any corporation which*
20 *is—*

21 “(i) *a surrogate foreign corporation (as*
22 *defined in section 7874(a)(2)(B)),*

23 “(ii) *a corporation which would be a*
24 *surrogate foreign corporation (as so defined)*

1 if “December 31, 1996” were substituted for
2 “March 4, 2003” in section 7874(a), or
3 “(iii) a corporation which is an expa-
4 triated entity (as defined in section
5 7874(a)) with respect to a corporation de-
6 scribed in clause (i) or (ii).”.

7 (2) *CONFORMING AMENDMENT.*—Paragraph
8 (5)(B)(ii) of section 163(j), as redesignated by para-
9 graph (1), is amended by striking “paragraph
10 (5)(B)” and inserting “paragraph (6)(B)”.

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

13 (1) *EXCEPTION FROM 163(j).*—Paragraph (4) of
14 section 163(j), as redesignated by subsection (a), is
15 amended by inserting “and” at the end of subpara-
16 graph (A), by striking “, and” at the end of subpara-
17 graph (B) and inserting a period, and by striking
18 subparagraph (C).

19 (2) *DISALLOWANCE.*—Section 856 is amended by
20 adding at the end the following new subsection:

21 “(n) *LIMITATION ON DEDUCTION FOR INTEREST ON*
22 *CERTAIN INDEBTEDNESS OF TAXABLE REIT SUB-*
23 *SIDIARY.*—

24 “(1) *LIMITATION.*—

1 “(A) *IN GENERAL.*—*If this subsection ap-*
2 *plies to any taxable REIT subsidiary for any*
3 *taxable year, no deduction shall be allowed under*
4 *this chapter for disqualified interest paid or ac-*
5 *crued by such subsidiary during such taxable*
6 *year. The amount disallowed under the preceding*
7 *sentence shall not exceed the subsidiary’s excess*
8 *interest expense for the taxable year.*

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

17 “(2) *SUBSIDIARIES TO WHICH SUBSECTION AP-*
18 *PLIES.*—

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

22 “(i) *such subsidiary has excess interest*
23 *expense for such taxable year, and*

24 “(ii) *the ratio of debt to equity of such*
25 *subsidiary as of the close of such taxable*

1 year (or on any other day during the tax-
2 able year as the Secretary may by regula-
3 tions prescribe) exceeds 1.5 to 1.

4 “(B) *EXCESS INTEREST EXPENSE.*—

5 “(i) *IN GENERAL.*—For purposes of
6 this subsection, the term ‘excess interest ex-
7 pense’ means the excess (if any) of—

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

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

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

1 *such succeeding taxable year (determined*
2 *without regard to the carryforward from the*
3 *taxable year of such 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 pur-*
12 *poses of this paragraph, the term ‘ratio of debt*
13 *to equity’ means the ratio which the total indebt-*
14 *edness of the subsidiary bears to the sum of its*
15 *money and all other assets reduced (but not*
16 *below zero) by such total indebtedness. The rules*
17 *of section 163(j)(6)(E) shall apply for purposes*
18 *of the preceding sentence.*

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

1 “(4) *OTHER RULES TO APPLY.*—*Rules similar to*
2 *the rules of paragraphs (7), (8), and (9) of section*
3 *163(j) shall apply for purposes of this subsection.*”

4 *(c) EFFECTIVE DATE.*—

5 (1) *IN GENERAL.*—*Except as otherwise provided*
6 *in this subsection, the amendments made by this sec-*
7 *tion shall apply to taxable years beginning after De-*
8 *cember 31, 2003.*

9 (2) *EARLIER EFFECTIVE DATE WITH RESPECT*
10 *TO EXPATRIATED CORPORATIONS, ETC.*—*The amend-*
11 *ments made by this section shall apply to taxable*
12 *years ending after March 4, 2003, in the case of a*
13 *taxpayer which is—*

14 (A) *a surrogate foreign corporation, as de-*
15 *fined in section 7874(a)(2)(B) of the Internal*
16 *Revenue Code of 1986, as added by section 2002,*

17 (B) *a corporation which would be a surro-*
18 *gate foreign corporation (as so defined) if “De-*
19 *cember 31, 1996” were substituted for “March 4,*
20 *2003” in such section 7874(a), or*

21 (C) *a corporation which is an expatriated*
22 *entity (as defined in such section 7874(a)) with*
23 *respect to a corporation described in subpara-*
24 *graph (A) or (B).*

1 *In applying such amendments to a taxpayer de-*
2 *scribed in the preceding sentence, subparagraph (B)*
3 *of section 163(j)(2) of such Code, as amended by this*
4 *section, shall be applied by substituting “25 percent”*
5 *for “35 percent”.*

6 (3) *LIMITATION ON CARRYOVER OF DISALLOWED*
7 *INTEREST.—*

8 (A) *IN GENERAL.—Except in the case of a*
9 *taxpayer described in paragraph (2), for pur-*
10 *poses of applying section 163(j)(1)(C) of the In-*
11 *ternal Revenue Code of 1986 (as added by this*
12 *section), amounts carried from a taxable year be-*
13 *ginning before January 1, 2004, to any taxable*
14 *year beginning after December 31, 2003, shall be*
15 *treated as disqualified interest described in sec-*
16 *tion 163(j)(3)(B) of such Code which is dis-*
17 *allowed for the most recent taxable year begin-*
18 *ning before January 1, 2004.*

19 (B) *EXPATRIATED CORPORATIONS.—In the*
20 *case of a taxpayer described in paragraph (2), a*
21 *rule similar to the rule of subparagraph (A)*
22 *shall apply to amounts carried from a taxable*
23 *year ending on or before March 5, 2003.*

1 **SEC. 2002. TAX TREATMENT OF EXPATRIATED ENTITIES**
2 **AND THEIR FOREIGN PARENTS.**

3 (a) *IN GENERAL.*—Subchapter C of chapter 80 (relat-
4 ing 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) *TAX ON INVERSION GAIN OF EXPATRIATED ENTI-*
9 *TIES.*—

10 “(1) *IN GENERAL.*—The taxable income of an ex-
11 patriated entity for any taxable year which includes
12 any portion of the applicable period shall in no event
13 be less than the inversion gain of the entity for the
14 taxable year.

15 “(2) *EXPATRIATED ENTITY.*—For purposes of
16 this subsection—

17 “(A) *IN GENERAL.*—The term ‘expatriated
18 entity’ means—

19 “(i) the domestic corporation or part-
20 nership referred to in subparagraph (B)(i)
21 with respect to which a foreign corporation
22 is a surrogate foreign corporation, and

23 “(ii) any United States person who is
24 related (within the meaning of section
25 267(b) or 707(b)(1)) to a domestic corpora-
26 tion or partnership described in clause (i).

1 “(B) *SURROGATE FOREIGN CORPORATION.*—
2 *A foreign corporation shall be treated as a surro-*
3 *gate foreign corporation if, pursuant to a plan*
4 *(or a series of related transactions)—*

5 “(i) *the entity completes after March 4,*
6 *2003, the direct or indirect acquisition of*
7 *substantially all of the properties held di-*
8 *rectly or indirectly by a domestic corpora-*
9 *tion or substantially all of the properties*
10 *constituting a trade or business of a domes-*
11 *tic partnership,*

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

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

20 “(II) *in the case of an acquisition*
21 *with respect to a domestic partnership,*
22 *by former partners of the domestic*
23 *partnership by reason of holding a*
24 *capital or profits interest in the domes-*
25 *tic partnership, and*

1 “(iii) after the acquisition the ex-
2 panded affiliated group which includes the
3 entity does not have substantial business ac-
4 tivities in the foreign country in which, or
5 under the law of which, the entity is created
6 or organized, when compared to the total
7 business activities of such expanded affili-
8 ated group.

9 An entity otherwise described in clause (i) with
10 respect to any domestic corporation or partner-
11 ship trade or business shall be treated as not so
12 described if, on or before March 4, 2003, such en-
13 tity acquired directly or indirectly more than
14 half of the properties held directly or indirectly
15 by such corporation or more than half of the
16 properties constituting such partnership trade or
17 business, as the case may be.

18 “(b) *DEFINITIONS AND SPECIAL RULES.*—

19 “(1) *EXPANDED AFFILIATED GROUP.*—The term
20 ‘expanded affiliated group’ means an affiliated group
21 as defined in section 1504(a) but without regard to
22 section 1504(b)(3), except that section 1504(a) shall
23 be applied by substituting ‘more than 50 percent’ for
24 ‘at least 80 percent’ each place it appears.

1 “(2) *CERTAIN STOCK DISREGARDED.*—*There*
2 *shall not be taken into account in determining owner-*
3 *ship under subsection (a)(2)(B)(i)—*

4 “(A) *stock held by members of the expanded*
5 *affiliated group which includes the foreign cor-*
6 *poration, or*

7 “(B) *stock of such foreign corporation which*
8 *is sold in a public offering related to the acquisi-*
9 *tion described in subsection (a)(2)(B)(i).*

10 “(3) *PLAN DEEMED IN CERTAIN CASES.*—*If a*
11 *foreign corporation acquires directly or indirectly*
12 *substantially all of the properties of a domestic cor-*
13 *poration or partnership during the 4-year period be-*
14 *ginning on the date which is 2 years before the owner-*
15 *ship requirements of subsection (a)(2)(B)(i) are met,*
16 *such actions shall be treated as pursuant to a plan.*

17 “(4) *CERTAIN TRANSFERS DISREGARDED.*—*The*
18 *transfer of properties or liabilities (including by con-*
19 *tribution or distribution) shall be disregarded if such*
20 *transfers are part of a plan a principal purpose of*
21 *which is to avoid the purposes of this section.*

22 “(5) *SPECIAL RULE FOR RELATED PARTNER-*
23 *SHIPS.*—*For purposes of applying subsection*
24 *(a)(2)(B)(i) to the acquisition of a trade or business*
25 *of a domestic partnership, except as provided in regu-*

1 *lations, all partnerships which are under common*
2 *control (within the meaning of section 482) shall be*
3 *treated as 1 partnership.*

4 “(6) *REGULATIONS.*—*The Secretary shall pre-*
5 *scribe such regulations as may be appropriate to de-*
6 *termine whether a corporation is a surrogate foreign*
7 *corporation, including regulations—*

8 “(A) *to treat warrants, options, contracts to*
9 *acquire stock, convertible debt interests, and*
10 *other similar interests as stock, and*

11 “(B) *to treat stock as not stock.*

12 “(c) *OTHER DEFINITIONS.*—*For purposes of this sec-*
13 *tion—*

14 “(1) *APPLICABLE PERIOD.*—*The term ‘applicable*
15 *period’ means the period—*

16 “(A) *beginning on the first date properties*
17 *are acquired as part of the acquisition described*
18 *in subsection (a)(2)(B)(i), and*

19 “(B) *ending on the date which is 10 years*
20 *after the last date properties are acquired as*
21 *part of such acquisition.*

22 “(2) *INVERSION GAIN.*—*The term ‘inversion*
23 *gain’ means the income or gain recognized by reason*
24 *of the transfer during the applicable period of stock*
25 *or other properties by an expatriated entity, and any*

1 *income received or accrued during the applicable pe-*
2 *riod by reason of a license of any property by an ex-*
3 *patriated entity—*

4 *“(A) as part of the acquisition described in*
5 *subsection (a)(2)(B)(i), or*

6 *“(B) after such acquisition if the transfer or*
7 *license is to a foreign related person.*

8 *Subparagraph (B) shall not apply to property de-*
9 *scribed in section 1221(a)(1) in the hands of the expa-*
10 *triated entity.*

11 *“(3) FOREIGN RELATED PERSON.—The term ‘for-*
12 *ign related person’ means, with respect to any expa-*
13 *triated entity, a foreign person which—*

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

16 *“(B) is under the same common control*
17 *(within the meaning of section 482) as such enti-*
18 *ty.*

19 *“(d) SPECIAL RULES.—*

20 *“(1) CREDITS NOT ALLOWED AGAINST TAX ON IN-*
21 *VERSION GAIN.—Credits (other than the credit allowed*
22 *by section 901) shall be allowed against the tax im-*
23 *posed by this chapter on an expatriated entity for*
24 *any taxable year described in subsection (a) only to*
25 *the extent such tax exceeds the product of—*

1 “(A) the amount of the inversion gain for
2 the taxable year, and

3 “(B) the highest rate of tax specified in sec-
4 tion 11(b)(1).

5 For purposes of determining the credit allowed by sec-
6 tion 901, inversion gain shall be treated as from
7 sources within the United States.

8 “(2) SPECIAL RULES FOR PARTNERSHIPS.—In
9 the case of an expatriated entity which is a partner-
10 ship—

11 “(A) subsection (a)(1) shall apply at the
12 partner rather than the partnership level,

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

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

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

24 “(C) the highest rate of tax specified in the
25 rate schedule applicable to the partner under this

1 *chapter shall be substituted for the rate of tax re-*
2 *ferred to in paragraph (1).*

3 “(3) *COORDINATION WITH SECTION 172 AND MIN-*
4 *IMUM TAX.—Rules similar to the rules of paragraphs*
5 *(3) and (4) of section 860E(a) shall apply for pur-*
6 *poses of subsection (a).*

7 “(4) *STATUTE OF LIMITATIONS.—*

8 “(A) *IN GENERAL.—The statutory period*
9 *for the assessment of any deficiency attributable*
10 *to the inversion gain of any taxpayer for any*
11 *pre-inversion year shall not expire before the ex-*
12 *piration of 3 years from the date the Secretary*
13 *is notified by the taxpayer (in such manner as*
14 *the Secretary may prescribe) of the acquisition*
15 *described in subsection (a)(2)(B)(i) to which*
16 *such gain relates and such deficiency may be as-*
17 *essed before the expiration of such 3-year period*
18 *notwithstanding the provisions of any other law*
19 *or rule of law which would otherwise prevent*
20 *such assessment.*

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

24 “(i) *any portion of the applicable pe-*
25 *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 (a)(2)(B)(i) is completed.

4 “(e) *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 hereafter
8 entered into, from the provisions of this section.

9 “(f) *REGULATIONS.*—The Secretary shall provide such
10 regulations as are necessary to carry out this section, in-
11 cluding regulations providing for such adjustments to the
12 application of this section as are necessary to prevent the
13 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 cease
19 to be (or not become) members of expanded affiliated
20 groups or related persons.”.

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

 “Sec. 7874. Rules relating to expatriated entities and their foreign
 parents.”

1 (c) *EFFECTIVE DATE.*—*The amendments made by this*
 2 *section shall apply to taxable years ending after March 4,*
 3 *2003.*

4 **SEC. 2003. EXCISE TAX ON STOCK COMPENSATION OF IN-**
 5 **SIDERS IN EXPATRIATED CORPORATIONS.**

6 (a) *IN GENERAL.*—*Subtitle D is amended by inserting*
 7 *after chapter 44 end the following new chapter:*

8 **“CHAPTER 45—PROVISIONS RELATING TO**
 9 **EXPATRIATED ENTITIES**

“Sec. 4985. Stock compensation of insiders in expatriated corpora-
tions.

10 **“SEC. 4985. STOCK COMPENSATION OF INSIDERS IN EXPA-**
 11 **TRIATED CORPORATIONS.**

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

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

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

1 “(A) in the case of a stock option (or other
2 similar right) or a stock appreciation right, the
3 fair value of such option or right, and

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

6 “(2) DATE FOR DETERMINING VALUE.—The de-
7 termination of value shall be made—

8 “(A) in the case of specified stock compensa-
9 tion held on the expatriation date, on such date,

10 “(B) in the case of such compensation which
11 is canceled during the 6 months before the expa-
12 triation date, on the day before such cancella-
13 tion, and

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

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

24 “(d) EXCEPTION WHERE GAIN RECOGNIZED ON COM-
25 PENSATION.—Subsection (a) shall not apply to—

1 “(1) any stock option which is exercised on the
2 expatriation date or during the 6-month period before
3 such date and to the stock acquired in such exercise,
4 if income is recognized under section 83 on or before
5 the expatriation date with respect to the stock ac-
6 quired pursuant to such exercise, and

7 “(2) any other specified stock compensation
8 which is exercised, sold, exchanged, distributed,
9 cashied-out, or otherwise paid during such period in
10 a transaction in which income, gain, or loss is recog-
11 nized in full.

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

13 “(1) DISQUALIFIED INDIVIDUAL.—The term ‘dis-
14 qualified 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 section
19 16(a) of the Securities Exchange Act of 1934
20 with respect to such corporation or any member
21 of the expanded affiliated group which includes
22 such corporation, or

23 “(B) would be subject to such requirements
24 if such corporation or member were an issuer of
25 equity securities referred to in such section.

1 “(2) *EXPATRIATED CORPORATION; EXPATRIATION*
2 *DATE.*—

3 “(A) *EXPATRIATED CORPORATION.*—*The*
4 *term ‘expatriated corporation’ means any cor-*
5 *poration which is an expatriated entity (as de-*
6 *fined in section 7874(a)(2)). Such term includes*
7 *any predecessor or successor of such a corpora-*
8 *tion.*

9 “(B) *EXPATRIATION DATE.*—*The term ‘ex-*
10 *patriation date’ means, with respect to a cor-*
11 *poration, the date on which the corporation first*
12 *becomes an expatriated corporation.*

13 “(3) *SPECIFIED STOCK COMPENSATION.*—

14 “(A) *IN GENERAL.*—*The term ‘specified*
15 *stock compensation’ means payment (or right to*
16 *payment) granted by the expatriated corporation*
17 *(or by any member of the expanded affiliated*
18 *group which includes such corporation) to any*
19 *person in connection with the performance of*
20 *services by a disqualified individual for such cor-*
21 *poration or member if the value of such payment*
22 *or right is based on (or determined by reference*
23 *to) the value (or change in value) of stock in*
24 *such corporation (or any such member).*

1 “(B) *EXCEPTIONS.*—*Such term shall not in-*
2 *clude—*

3 “(i) *any option to which part II of*
4 *subchapter D of chapter 1 applies, or*

5 “(ii) *any payment or right to payment*
6 *from a plan referred to in section*
7 *280G(b)(6).*

8 “(4) *EXPANDED AFFILIATED GROUP.*—*The term*
9 *‘expanded affiliated group’ means an affiliated group*
10 *(as defined in section 1504(a) without regard to sec-*
11 *tion 1504(b)(3)); except that section 1504(a) shall be*
12 *applied by substituting ‘more than 50 percent’ for ‘at*
13 *least 80 percent’ each place it appears.*

14 “(f) *SPECIAL RULES.*—*For purposes of this section—*

15 “(1) *CANCELLATION OF RESTRICTION.*—*The can-*
16 *cellation of a restriction which by its terms will never*
17 *lapse shall be treated as a grant.*

18 “(2) *PAYMENT OR REIMBURSEMENT OF TAX BY*
19 *CORPORATION TREATED AS SPECIFIED STOCK COM-*
20 *PENSATION.*—*Any payment of the tax imposed by this*
21 *section directly or indirectly by the expatriated cor-*
22 *poration or by any member of the expanded affiliated*
23 *group which includes such corporation—*

24 “(A) *shall be treated as specified stock com-*
25 *pensation, and*

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

3 “(3) CERTAIN RESTRICTIONS IGNORED.—Wheth-
4 er there is specified stock compensation, and the value
5 thereof, shall be determined without regard to any re-
6 striction other than a restriction which by its terms
7 will never lapse.

8 “(4) PROPERTY TRANSFERS.—Any transfer of
9 property shall be treated as a payment and any right
10 to a transfer of property shall be treated as a right
11 to a payment.

12 “(5) OTHER ADMINISTRATIVE PROVISIONS.—For
13 purposes of subtitle F, any tax imposed by this sec-
14 tion shall be treated as a tax imposed by subtitle A.

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

18 (b) DENIAL OF DEDUCTION.—

19 (1) IN GENERAL.—Paragraph (6) of section
20 275(a) is amended by inserting “45,” before “46,”.

21 (2) \$1,000,000 LIMIT ON DEDUCTIBLE COM-
22 PENSATION REDUCED BY PAYMENT OF EXCISE TAX ON
23 SPECIFIED STOCK COMPENSATION.—Paragraph (4) of
24 section 162(m) is amended by adding at the end the
25 following new subparagraph:

1 “(G) *COORDINATION WITH EXCISE TAX ON*
2 *SPECIFIED STOCK COMPENSATION.*—*The dollar*
3 *limitation contained in paragraph (1) with re-*
4 *spect to any covered employee shall be reduced*
5 *(but not below zero) by the amount of any pay-*
6 *ment (with respect to such employee) of the tax*
7 *imposed by section 4985 directly or indirectly by*
8 *the expatriated corporation (as defined in such*
9 *section) or by any member of the expanded affili-*
10 *ated group (as defined in such section) which in-*
11 *cludes such corporation.”*

12 (c) *CONFORMING AMENDMENTS.*—

13 (1) *The last sentence of section 3121(v)(2)(A) is*
14 *amended by inserting before the period “or to any*
15 *specified stock compensation (as defined in section*
16 *4985) on which tax is imposed by section 4985”.*

17 (2) *The table of chapters for subtitle D is amend-*
18 *ed by inserting after the item relating to chapter 44*
19 *the following new item:*

 “Chapter 45. Provisions relating to expatriated entities.”

20 (d) *EFFECTIVE DATE.*—*The amendments made by this*
21 *section shall take effect on March 4, 2003; except that peri-*
22 *ods before such date shall not be taken into account in ap-*
23 *plying the periods in subsections (a) and (e)(1) of section*
24 *4985 of the Internal Revenue Code of 1986, as added by*
25 *this section.*

1 **SEC. 2004. REINSURANCE OF UNITED STATES RISKS IN FOR-**
2 **EIGN JURISDICTIONS.**

3 (a) *IN GENERAL.*—Section 845(a) (relating to alloca-
4 tion in case of reinsurance agreement involving tax avoid-
5 ance or evasion) is amended by striking “source and char-
6 acter” and inserting “amount, source, or character”.

7 (b) *EFFECTIVE DATE.*—The amendments made by this
8 section shall apply to any risk reinsured after the date of
9 the enactment of this Act.

10 **SEC. 2005. REVISION OF TAX RULES ON EXPATRIATION OF**
11 **INDIVIDUALS.**

12 (a) *EXPATRIATION TO AVOID TAX.*—

13 (1) *IN GENERAL.*—Subsection (a) of section 877
14 (relating to treatment of expatriates) is amended to
15 read as follows:

16 “(a) *TREATMENT OF EXPATRIATES.*—

17 “(1) *IN GENERAL.*—Every nonresident alien in-
18 dividual to whom this section applies and who, with-
19 in the 10-year period immediately preceding the close
20 of the taxable year, lost United States citizenship
21 shall be taxable for such taxable year in the manner
22 provided in subsection (b) if the tax imposed pursu-
23 ant to such subsection (after any reduction in such
24 tax under the last sentence of such subsection) exceeds
25 the tax which, without regard to this section, is im-
26 posed pursuant to section 871.

1 “(2) *INDIVIDUALS SUBJECT TO THIS SECTION.*—

2 *This section shall apply to any individual if—*

3 “(A) *the average annual net income tax (as*
4 *defined in section 38(c)(1)) of such individual*
5 *for the period of 5 taxable years ending before*
6 *the date of the loss of United States citizenship*
7 *is greater than \$122,000,*

8 “(B) *the net worth of the individual as of*
9 *such date is \$2,000,000 or more, or*

10 “(C) *such individual fails to certify under*
11 *penalty of perjury that he has met the require-*
12 *ments of this title for the 5 preceding taxable*
13 *years or fails to submit such evidence of such*
14 *compliance as the Secretary may require.*

15 *In the case of the loss of United States citizenship in*
16 *any calendar year after 2003, such \$122,000 amount*
17 *shall be increased by an amount equal to such dollar*
18 *amount multiplied by the cost-of-living adjustment*
19 *determined under section 1(f)(3) for such calendar*
20 *year by substituting ‘2002’ for ‘1992’ in subpara-*
21 *graph (B) thereof. Any increase under the preceding*
22 *sentence shall be rounded to the nearest multiple of*
23 *\$1,000.”.*

24 (2) *REVISION OF EXCEPTIONS FROM ALTER-*
25 *NATIVE TAX.*—*Subsection (c) of section 877 (relating*

1 *to tax avoidance not presumed in certain cases) is*
2 *amended to read as follows:*

3 “(c) *EXCEPTIONS.*—

4 “(1) *IN GENERAL.*—*Subparagraphs (A) and (B)*
5 *of subsection (a)(2) shall not apply to an individual*
6 *described in paragraph (2) or (3).*

7 “(2) *DUAL CITIZENS.*—

8 “(A) *IN GENERAL.*—*An individual is de-*
9 *scribed in this paragraph if—*

10 “(i) *the individual became at birth a*
11 *citizen of the United States and a citizen of*
12 *another country and continues to be a cit-*
13 *izen of such other country, and*

14 “(ii) *the individual has had no sub-*
15 *stantial contacts with the United States.*

16 “(B) *SUBSTANTIAL CONTACTS.*—*An indi-*
17 *vidual shall be treated as having no substantial*
18 *contacts with the United States only if the indi-*
19 *vidual—*

20 “(i) *was never a resident of the United*
21 *States (as defined in section 7701(b)),*

22 “(ii) *has never held a United States*
23 *passport, and*

24 “(iii) *was not present in the United*
25 *States for more than 30 days during any*

1 *calendar year which is 1 of the 10 calendar*
2 *years preceding the individual's loss of*
3 *United States citizenship.*

4 “(3) *CERTAIN MINORS.*—*An individual is de-*
5 *scribed in this paragraph if—*

6 “(A) *the individual became at birth a cit-*
7 *izen of the United States,*

8 “(B) *neither parent of such individual was*
9 *a citizen of the United States at the time of such*
10 *birth,*

11 “(C) *the individual's loss of United States*
12 *citizenship occurs before such individual attains*
13 *age 18¹/₂, and*

14 “(D) *the individual was not present in the*
15 *United States for more than 30 days during any*
16 *calendar year which is 1 of the 10 calendar*
17 *years preceding the individual's loss of United*
18 *States citizenship.”.*

19 (3) *CONFORMING AMENDMENT.*—*Section 2107(a)*
20 *is amended to read as follows:*

21 “(a) *TREATMENT OF EXPATRIATES.*—*A tax computed*
22 *in accordance with the table contained in section 2001 is*
23 *hereby imposed on the transfer of the taxable estate, deter-*
24 *mined as provided in section 2106, of every decedent non-*
25 *resident not a citizen of the United States if the date of*

1 *death occurs during a taxable year with respect to which*
2 *the decedent is subject to tax under section 877(b).”.*

3 **(b) SPECIAL RULES FOR DETERMINING WHEN AN IN-**
4 *DIVIDUAL IS NO LONGER A UNITED STATES CITIZEN OR*
5 *LONG-TERM RESIDENT.—Section 7701 (relating to defini-*
6 *tions) is amended by redesignating subsection (n) as sub-*
7 *section (o) and by inserting after subsection (m) the fol-*
8 *lowing new subsection:*

9 **“(n) SPECIAL RULES FOR DETERMINING WHEN AN IN-**
10 *DIVIDUAL IS NO LONGER A UNITED STATES CITIZEN OR*
11 *LONG-TERM RESIDENT.—An individual who would (but*
12 *for this subsection) cease to be treated as a citizen or resi-*
13 *dent of the United States shall continue to be treated as*
14 *a citizen or resident of the United States, as the case may*
15 *be, until such individual—*

16 **“(1) gives notice of an expatriating act or termi-**
17 *nation of residency (with the requisite intent to relin-*
18 *quish citizenship or terminate residency) to the Sec-*
19 *retary of State or the Secretary of Homeland Secu-*
20 *rity, and*

21 **“(2) provides a statement in accordance with**
22 *section 6039G.”.*

23 **(c) PHYSICAL PRESENCE IN THE UNITED STATES FOR**
24 *MORE THAN 30 DAYS.—Section 877 (relating to expatria-*

1 *tion to avoid tax) is amended by adding at the end the*
2 *following new subsection:*

3 “(g) *PHYSICAL PRESENCE.*—

4 “(1) *IN GENERAL.*—*This section shall not apply*
5 *to any individual to whom this section would other-*
6 *wise apply for any taxable year during the 10-year*
7 *period referred to in subsection (a) in which such in-*
8 *dividual is physically present in the United States at*
9 *any time on more than 30 days in the calendar year*
10 *ending in such taxable year, and such individual*
11 *shall be treated for purposes of this title as a citizen*
12 *or resident of the United States, as the case may be,*
13 *for such taxable year.*

14 “(2) *EXCEPTION.*—

15 “(A) *IN GENERAL.*—*In the case of an indi-*
16 *vidual described in any of the following subpara-*
17 *graphs of this paragraph, a day of physical pres-*
18 *ence in the United States shall be disregarded if*
19 *the individual is performing services in the*
20 *United States on such day for an employer. The*
21 *preceding sentence shall not apply if—*

22 “(i) *such employer is related (within*
23 *the meaning of section 267 and 707) to such*
24 *individual, or*

1 “(i) such employer fails to meet such
2 requirements as the Secretary may prescribe
3 by regulations to prevent the avoidance of
4 the purposes of this paragraph.

5 Not more than 30 days during any calendar
6 year may be disregarded under this subpara-
7 graph.

8 “(B) INDIVIDUALS WITH TIES TO OTHER
9 COUNTRIES.—An individual is described in this
10 subparagraph if—

11 “(i) the individual becomes (not later
12 than the close of a reasonable period after
13 loss of United States citizenship or termi-
14 nation of residency) a citizen or resident of
15 the country in which—

16 “(I) such individual was born,

17 “(II) if such individual is mar-
18 ried, such individual’s spouse was
19 born, or

20 “(III) either of such individual’s
21 parents were born, and

22 “(ii) the individual becomes fully liable
23 for income tax in such country.

24 “(C) MINIMAL PRIOR PHYSICAL PRESENCE
25 IN THE UNITED STATES.—An individual is de-

1 *scribed in this subparagraph if, for each year in*
2 *the 10-year period ending on the date of loss of*
3 *United States citizenship or termination of resi-*
4 *dency, the individual was physically present in*
5 *the United States for 30 days or less. The rule*
6 *of section 7701(b)(3)(D)(ii) shall apply for pur-*
7 *poses of this subparagraph.”.*

8 *(d) TRANSFERS SUBJECT TO GIFT TAX.—*

9 *(1) IN GENERAL.—Subsection (a) of section 2501*
10 *(relating to taxable transfers) is amended by striking*
11 *paragraph (4), by redesignating paragraph (5) as*
12 *paragraph (4), and by striking paragraph (3) and*
13 *inserting the following new paragraph:*

14 “(3) EXCEPTION.—

15 “(A) CERTAIN INDIVIDUALS.—Paragraph
16 (2) shall not apply in the case of a donor to
17 whom section 877(b) applies for the taxable year
18 which includes the date of the transfer.

19 “(B) CREDIT FOR FOREIGN GIFT TAXES.—

20 *The tax imposed by this section solely by reason*
21 *of this paragraph shall be credited with the*
22 *amount of any gift tax actually paid to any for-*
23 *ign country in respect of any gift which is tax-*
24 *able under this section solely by reason of this*
25 *paragraph.”*

1 (2) *TRANSFERS OF CERTAIN STOCK.*—*Subsection*
2 *(a) of section 2501 is amended by adding at the end*
3 *the following new paragraph:*

4 “(5) *TRANSFERS OF CERTAIN STOCK.*—

5 “(A) *IN GENERAL.*—*In the case of a trans-*
6 *fer of stock in a foreign corporation described in*
7 *subparagraph (B) by a donor to whom section*
8 *877(b) applies for the taxable year which in-*
9 *cludes the date of the transfer—*

10 “(i) *section 2511(a) shall be applied*
11 *without regard to whether such stock is situ-*
12 *ated within the United States, and*

13 “(ii) *the value of such stock for pur-*
14 *poses of this chapter shall be its U.S.-asset*
15 *value determined under subparagraph (C).*

16 “(B) *FOREIGN CORPORATION DESCRIBED.*—
17 *A foreign corporation is described in this sub-*
18 *paragraph with respect to a donor if—*

19 “(i) *the donor owned (within the*
20 *meaning of section 958(a)) at the time of*
21 *such transfer 10 percent or more of the total*
22 *combined voting power of all classes of stock*
23 *entitled to vote of the foreign corporation,*
24 *and*

1 “(ii) such donor owned (within the
2 meaning of section 958(a)), or is considered
3 to have owned (by applying the ownership
4 rules of section 958(b)), at the time of such
5 transfer, more than 50 percent of—

6 “(I) the total combined voting
7 power of all classes of stock entitled to
8 vote of such corporation, or

9 “(II) the total value of the stock of
10 such corporation.

11 “(C) U.S.-ASSET VALUE.—For purposes of
12 subparagraph (A), the U.S.-asset value of stock
13 shall be the amount which bears the same ratio
14 to the fair market value of such stock at the time
15 of transfer as—

16 “(i) the fair market value (at such
17 time) of the assets owned by such foreign
18 corporation and situated in the United
19 States, bears to

20 “(ii) the total fair market value (at
21 such time) of all assets owned by such for-
22 eign corporation.”

23 (e) ENHANCED INFORMATION REPORTING FROM INDI-
24 VIDUALS LOSING UNITED STATES CITIZENSHIP.—

1 (1) *IN GENERAL.*—Subsection (a) of section
2 6039G is amended to read as follows:

3 “(a) *IN GENERAL.*—Notwithstanding any other provi-
4 sion of law, any individual to whom section 877(b) applies
5 for any taxable year shall provide a statement for such tax-
6 able year which includes the information described in sub-
7 section (b).”.

8 (2) *INFORMATION TO BE PROVIDED.*—Subsection
9 (b) of section 6039G is amended to read as follows:

10 “(b) *INFORMATION TO BE PROVIDED.*—Information
11 required under subsection (a) shall include—

12 “(1) the taxpayer’s TIN,

13 “(2) the mailing address of such individual’s
14 principal foreign residence,

15 “(3) the foreign country in which such indi-
16 vidual is residing,

17 “(4) the foreign country of which such individual
18 is a citizen,

19 “(5) information detailing the income, assets,
20 and liabilities of such individual,

21 “(6) the number of days during any portion of
22 which that the individual was physically present in
23 the United States during the taxable year, and

24 “(7) such other information as the Secretary
25 may prescribe.”.

1 (3) *INCREASE IN PENALTY.*—*Subsection (d) of*
 2 *section 6039G is amended to read as follows:*

3 “(d) *PENALTY.*—*If—*

4 “(1) *an individual is required to file a statement*
 5 *under subsection (a) for any taxable year, and*

6 “(2) *fails to file such a statement with the Sec-*
 7 *retary on or before the date such statement is required*
 8 *to be filed or fails to include all the information re-*
 9 *quired to be shown on the statement or includes incor-*
 10 *rect information,*

11 *such individual shall pay a penalty of \$10,000 unless it*
 12 *is shown that such failure is due to reasonable cause and*
 13 *not to willful neglect.”.*

14 (4) *CONFORMING AMENDMENT.*—*Section 6039G*
 15 *is amended by striking subsections (c), (f), and (g)*
 16 *and by redesignating subsections (d) and (e) as sub-*
 17 *section (c) and (d), respectively.*

18 (f) *EFFECTIVE DATE.*—*The amendments made by this*
 19 *section shall apply to individuals who expatriate after Feb-*
 20 *ruary 27, 2003.*

21 **SEC. 2006. REPORTING OF TAXABLE MERGERS AND ACQUI-**
 22 **SITIONS.**

23 (a) *IN GENERAL.*—*Subpart B of part III of subchapter*
 24 *A of chapter 61 is amended by inserting after section 6043*
 25 *the following new section:*

1 **“SEC. 6043A. RETURNS RELATING TO TAXABLE MERGERS**
2 **AND ACQUISITIONS.**

3 *“(a) IN GENERAL.—According to the forms or regula-*
4 *tions prescribed by the Secretary, the acquiring corporation*
5 *in any taxable acquisition shall make a return setting*
6 *forth—*

7 *“(1) a description of the acquisition,*

8 *“(2) the name and address of each shareholder of*
9 *the acquired corporation who is required to recognize*
10 *gain (if any) as a result of the acquisition,*

11 *“(3) the amount of money and the fair market*
12 *value of other property transferred to each such share-*
13 *holder as part of such acquisition, and*

14 *“(4) such other information as the Secretary*
15 *may prescribe.*

16 *To the extent provided by the Secretary, the requirements*
17 *of this section applicable to the acquiring corporation shall*
18 *be applicable to the acquired corporation and not to the*
19 *acquiring corporation.*

20 *“(b) NOMINEES.—According to the forms or regula-*
21 *tions prescribed by the Secretary—*

22 *“(1) REPORTING.—Any person who holds stock*
23 *as a nominee for another person shall furnish in the*
24 *manner prescribed by the Secretary to such other per-*
25 *son the information provided by the corporation*
26 *under subsection (d).*

1 “(2) *REPORTING TO NOMINEES.*—*In the case of*
2 *stock held by any person as a nominee, references in*
3 *this section (other than in subsection (c)) to a share-*
4 *holder shall be treated as a reference to the nominee.*

5 “(c) *TAXABLE ACQUISITION.*—*For purposes of this sec-*
6 *tion, the term ‘taxable acquisition’ means any acquisition*
7 *by a corporation of stock in or property of another corpora-*
8 *tion if any shareholder of the acquired corporation is re-*
9 *quired to recognize gain (if any) as a result of such acquisi-*
10 *tion.*

11 “(d) *STATEMENTS TO BE FURNISHED TO SHARE-*
12 *HOLDERS.*—*According to the forms or regulations pre-*
13 *scribed by the Secretary, every person required to make a*
14 *return under subsection (a) shall furnish to each share-*
15 *holder whose name is required to be set forth in such return*
16 *a written statement showing—*

17 “(1) *the name, address, and phone number of the*
18 *information contact of the person required to make*
19 *such return,*

20 “(2) *the information required to be shown on*
21 *such return with respect to such shareholder, and*

22 “(3) *such other information as the Secretary*
23 *may prescribe.*

24 *The written statement required under the preceding sen-*
25 *tence shall be furnished to the shareholder on or before Jan-*

1 uary 31 of the year following the calendar year during
2 which the taxable acquisition occurred.”

3 (b) *ASSESSABLE PENALTIES.*—

4 (1) Subparagraph (B) of section 6724(d)(1) (re-
5 lating to definitions) is amended by redesignating
6 clauses (ii) through (xviii) as clauses (iii) through
7 (xix), respectively, and by inserting after clause (i)
8 the following new clause:

9 “(ii) section 6043A(a) (relating to re-
10 turns relating to taxable mergers and acqui-
11 sitions),”.

12 (2) Paragraph (2) of section 6724(d) is amended
13 by redesignating subparagraphs (F) through (BB) as
14 subparagraphs (G) through (CC), respectively, and by
15 inserting after subparagraph (E) the following new
16 subparagraph:

17 “(F) subsections (b) and (d) of section
18 6043A (relating to returns relating to taxable
19 mergers and acquisitions).”.

20 (c) *CLERICAL AMENDMENT.*—The table of sections for
21 subpart B of part III of subchapter A of chapter 61 is
22 amended by inserting after the item relating to section 6043
23 the following new item:

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

1 (d) *EFFECTIVE DATE.*—*The amendments made by this*
2 *section shall apply to acquisitions after the date of the en-*
3 *actment of this Act.*

4 **SEC. 2007. STUDIES.**

5 (a) *TRANSFER PRICING RULES.*—*The Secretary of the*
6 *Treasury or the Secretary’s delegate shall conduct a study*
7 *regarding the effectiveness of current transfer pricing rules*
8 *and compliance efforts in ensuring that cross-border trans-*
9 *fers and other related-party transactions, particularly*
10 *transactions involving intangible assets, service contracts,*
11 *or leases cannot be used improperly to shift income out of*
12 *the United States. The study shall include a review of the*
13 *contemporaneous documentation and penalty rules under*
14 *section 6662 of the Internal Revenue Code of 1986, a review*
15 *of the regulatory and administrative guidance imple-*
16 *menting the principles of section 482 of such Code to trans-*
17 *actions involving intangible property and services and to*
18 *cost-sharing arrangements, and an examination of whether*
19 *increased disclosure of cross-border transactions should be*
20 *required. The study shall set forth specific recommendations*
21 *to address all abuses identified in the study. Not later than*
22 *June 30, 2004, such Secretary or delegate shall submit to*
23 *the Congress a report of such study.*

24 (b) *INCOME TAX TREATIES.*—*The Secretary of the*
25 *Treasury or the Secretary’s delegate shall conduct a study*

1 *of United States income tax treaties to identify any inap-*
2 *propriate reductions in United States withholding tax that*
3 *provide opportunities for shifting income out of the United*
4 *States, and to evaluate whether existing anti-abuse mecha-*
5 *nisms are operating properly. The study shall include spe-*
6 *cific recommendations to address all inappropriate uses of*
7 *tax treaties. Not later than June 30, 2004, such Secretary*
8 *or delegate shall submit to the Congress a report of such*
9 *study.*

10 (c) *IMPACT OF CORPORATE EXPATRIATION PROVI-*
11 *SIONS.—The Secretary of the Treasury or the Secretary’s*
12 *delegate shall conduct a study of the impact of the provi-*
13 *sions of this title on earnings stripping and corporate expa-*
14 *triation. The study shall include such recommendations as*
15 *such Secretary or delegate may have to improve the impact*
16 *of such provisions in carrying out the purposes of this title.*
17 *Not later than December 31, 2005, such Secretary or dele-*
18 *gate shall submit to the Congress a report of such study.*

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

5 **SEC. 3001. PENALTY FOR FAILING TO DISCLOSE REPORT-**
6 **ABLE TRANSACTIONS.**

7 (a) *IN GENERAL.*—Part I of subchapter B of chapter
8 68 (relating to assessable penalties) is amended by inserting
9 after section 6707 the following new section:

10 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**
11 **ABLE TRANSACTION INFORMATION WITH RE-**
12 **TURN.**

13 “(a) *IMPOSITION OF PENALTY.*—Any person who fails
14 to include on any return or statement any information with
15 respect to a reportable transaction which is required under
16 section 6011 to be included with such return or statement
17 shall pay a penalty in the amount determined under sub-
18 section (b).

19 “(b) *AMOUNT OF PENALTY.*—

20 “(1) *IN GENERAL.*—Except as provided in para-
21 graph (2), the amount of the penalty under subsection
22 (a) shall be—

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

25 “(B) \$50,000 in any other case.

1 “(2) *LISTED TRANSACTION.*—*The amount of the*
2 *penalty under subsection (a) with respect to a listed*
3 *transaction shall be—*

4 “(A) *\$100,000 in the case of a natural per-*
5 *son, and*

6 “(B) *\$200,000 in any other case.*

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

8 “(1) *REPORTABLE TRANSACTION.*—*The term ‘re-*
9 *portable transaction’ means any transaction with re-*
10 *spect to which information is required to be included*
11 *with a return or statement because, as determined*
12 *under regulations prescribed under section 6011, such*
13 *transaction is of a type which the Secretary deter-*
14 *mines as having a potential for tax avoidance or eva-*
15 *sion.*

16 “(2) *LISTED TRANSACTION.*—*The term ‘listed*
17 *transaction’ means a reportable transaction which is*
18 *the same as, or substantially similar to, a transaction*
19 *specifically identified by the Secretary as a tax avoid-*
20 *ance transaction for purposes of section 6011.*

21 “(d) *AUTHORITY TO RESCIND PENALTY.*—

22 “(1) *IN GENERAL.*—*The Commissioner of Inter-*
23 *nal Revenue may rescind all or any portion of any*
24 *penalty imposed by this section with respect to any*
25 *violation if—*

1 “(A) the violation is with respect to a re-
2 portable transaction other than a listed trans-
3 action, and

4 “(B) rescinding the penalty would promote
5 compliance with the requirements of this title
6 and effective tax administration.

7 “(2) NO JUDICIAL APPEAL.—Notwithstanding
8 any other provision of law, any determination under
9 this subsection may not be reviewed in any judicial
10 proceeding.

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

17 “(A) a statement of the facts and cir-
18 cumstances relating to the violation,

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

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

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

24 (b) CONFORMING AMENDMENT.—The table of sections
25 for part I of subchapter B of chapter 68 is amended by

1 *inserting after the item relating to section 6707 the fol-*
 2 *lowing:*

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

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

6 *(d) REPORT.—The Commissioner of Internal Revenue*
 7 *shall annually report to the Committee on Ways and Means*
 8 *of the House of Representatives and the Committee on Fi-*
 9 *nance of the Senate—*

10 *(1) a summary of the total number and aggre-*
 11 *gate amount of penalties imposed, and rescinded,*
 12 *under section 6707A of the Internal Revenue Code of*
 13 *1986, and*

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

16 **SEC. 3002. ACCURACY-RELATED PENALTY FOR LISTED**
 17 **TRANSACTIONS, OTHER REPORTABLE TRANS-**
 18 **ACTIONS HAVING A SIGNIFICANT TAX AVOID-**
 19 **ANCE PURPOSE, ETC.**

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

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

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

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

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

12 “(A) the product of—

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

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

22 “(B) the amount of the decrease (if any) in
23 the aggregate amount of credits determined
24 under subtitle A which results from a difference
25 between the taxpayer’s treatment of an item to
26 which this section applies (as shown on the tax-

1 payer's return of tax) and the proper tax treat-
2 ment of such item.

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

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

12 “(A) any listed transaction, and

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

17 “(c) *HIGHER PENALTY FOR NONDISCLOSED TRANS-*
18 *ACTIONS.*—Subsection (a) shall be applied by substituting
19 ‘30 percent’ for ‘20 percent’ with respect to the portion of
20 any reportable transaction understatement with respect to
21 which the requirement of section 6664(d)(2)(A) is not met.

22 “(d) *DEFINITIONS OF REPORTABLE AND LISTED*
23 *TRANSACTIONS.*—For purposes of this section, the terms ‘re-
24 portable transaction’ and ‘listed transaction’ have the re-
25 spective meanings given to such terms by section 6707A(c).

1 “(e) *SPECIAL RULES.*—

2 “(1) *COORDINATION WITH PENALTIES, ETC., ON*
3 *OTHER UNDERSTATEMENTS.*—*In the case of an under-*
4 *statement (as defined in section 6662(d)(2))—*

5 “(A) *the amount of such understatement*
6 *(determined without regard to this paragraph)*
7 *shall be increased by the aggregate amount of re-*
8 *portable transaction understatements for pur-*
9 *poses of determining whether such understate-*
10 *ment is a substantial understatement under sec-*
11 *tion 6662(d)(1), and*

12 “(B) *the addition to tax under section*
13 *6662(a) shall apply only to the excess of the*
14 *amount of the substantial understatement (if*
15 *any) after the application of subparagraph (A)*
16 *over the aggregate amount of reportable trans-*
17 *action understatements.*

18 “(2) *COORDINATION WITH OTHER PENALTIES.*—

19 “(A) *APPLICATION OF FRAUD PENALTY.*—
20 *References to an underpayment in section 6663*
21 *shall be treated as including references to a re-*
22 *portable transaction understatement.*

23 “(B) *NO DOUBLE PENALTY.*—*This section*
24 *shall not apply to any portion of an understate-*

1 *ment on which a penalty is imposed under sec-*
2 *tion 6663.*

3 “(3) *SPECIAL RULE FOR AMENDED RETURNS.—*
4 *Except as provided in regulations, in no event shall*
5 *any tax treatment included with an amendment or*
6 *supplement to a return of tax be taken into account*
7 *in determining the amount of any reportable trans-*
8 *action understatement if the amendment or supple-*
9 *ment is filed after the earlier of the date the taxpayer*
10 *is first contacted by the Secretary regarding the ex-*
11 *amination of the return or such other date as is speci-*
12 *fied by the Secretary.”*

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

16 *“The excess under the preceding sentence shall be*
17 *determined without regard to items to which sec-*
18 *tion 6662A applies.”*

19 (c) *REASONABLE CAUSE EXCEPTION.—*

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

22 “(d) *REASONABLE CAUSE EXCEPTION FOR REPORT-*
23 *ABLE TRANSACTION UNDERSTATEMENTS.—*

24 *“(1) IN GENERAL.—No penalty shall be imposed*
25 *under section 6662A with respect to any portion of a*

1 *reportable transaction understatement if it is shown*
2 *that there was a reasonable cause for such portion*
3 *and that the taxpayer acted in good faith with respect*
4 *to such portion.*

5 “(2) *SPECIAL RULES.*—*Paragraph (1) shall not*
6 *apply to any reportable transaction understatement*
7 *unless—*

8 “(A) *the relevant facts affecting the tax*
9 *treatment of the item are adequately disclosed in*
10 *accordance with the regulations prescribed under*
11 *section 6011,*

12 “(B) *there is or was substantial authority*
13 *for such treatment, and*

14 “(C) *the taxpayer reasonably believed that*
15 *such treatment was more likely than not the*
16 *proper treatment.*

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

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 respect*

1 to the tax treatment of an item only if such be-
2 lief—

3 “(i) is based on the facts and law that
4 exist at the time the return of tax which in-
5 cludes 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 estab-
17 lish the reasonable belief of a taxpayer if—

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

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

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

1 “(I) is a material advisor (within
2 the meaning of section 6111(b)(1)) and
3 participates in the organization, man-
4 agement, promotion, or sale of the
5 transaction or is related (within the
6 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 with
13 respect to the transaction which is con-
14 tingent on all or part of the intended
15 tax benefits from the transaction being
16 sustained, or

17 “(IV) as determined under regula-
18 tions prescribed by the Secretary, has a
19 disqualifying financial interest with
20 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 fac-
2 tual or legal assumptions (including
3 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 section
18 6664 is amended by inserting “FOR UNDERPAY-
19 MENTS” 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 entity,*

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

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

13 *if a significant purpose of such partnership,*
14 *entity, plan, or arrangement is the avoid-*
15 *ance or evasion of Federal income tax.”*

16 (e) *CONFORMING AMENDMENTS.—*

17 (1) *Sections 461(i)(3)(C), 1274(b)(3), and*
18 *7525(b) are each amended by striking “section*
19 *6662(d)(2)(C)(iii)” and inserting “section*
20 *6662(d)(2)(C)(ii)”.*

21 (2) *The heading for section 6662 is amended to*
22 *read as follows:*

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

3 *(3) The table of sections for part II of subchapter*
 4 *A of chapter 68 is amended by striking the item relat-*
 5 *ing to section 6662 and inserting the following new*
 6 *items:*

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

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

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

10 **SEC. 3003. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
 11 **PRIVILEGES RELATING TO TAXPAYER COM-**
 12 **MUNICATIONS.**

13 *(a) IN GENERAL.—Section 7525(b) (relating to section*
 14 *not to apply to communications regarding corporate tax*
 15 *shelters) is amended to read as follows:*

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

20 *“(1) between a federally authorized tax practi-*
 21 *tioner and—*

22 *“(A) any person,*

1 “(B) any director, officer, employee, agent,
2 or representative of the person, or

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

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

8 (b) *EFFECTIVE DATE.*—The amendment made by this
9 section shall apply to communications made on or after the
10 date of the enactment of this Act.

11 **SEC. 3004. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
12 **FOR WHICH REQUIRED LISTED TRANS-**
13 **ACTIONS NOT REPORTED.**

14 (a) *IN GENERAL.*—Section 6501(c) (relating to excep-
15 tions) is amended by adding at the end the following new
16 paragraph:

17 “(10) *LISTED TRANSACTIONS.*—If a taxpayer
18 fails to include on any return or statement for any
19 taxable year any information with respect to a listed
20 transaction (as defined in section 6707A(c)(2)) which
21 is required under section 6011 to be included with
22 such return or statement, the time for assessment of
23 any tax imposed by this title with respect to such
24 transaction shall not expire before the date which is
25 1 year after the earlier of—

1 “(A) the date on which the Secretary is fur-
2 nished the information so required, or

3 “(B) the date that a material advisor (as
4 defined in section 6111) meets the requirements
5 of section 6112 with respect to a request by the
6 Secretary under section 6112(b) relating to such
7 transaction with respect to such taxpayer.”

8 (b) *EFFECTIVE DATE.*—The amendment made by this
9 section shall apply to taxable years with respect to which
10 the period for assessing a deficiency did not expire before
11 the date of the enactment of this Act.

12 **SEC. 3005. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

19 “(1) information identifying and describing the
20 transaction,

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

23 “(3) such other information as the Secretary
24 may prescribe.

1 *Such return shall be filed not later than the date specified*
2 *by the Secretary.*

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

4 “(1) *MATERIAL ADVISOR.—*

5 “(A) *IN GENERAL.—The term ‘material ad-*
6 *visor’ means any person—*

7 “(i) *who provides any material aid,*
8 *assistance, or advice with respect to orga-*
9 *nizing, managing, promoting, selling, im-*
10 *plementing, or carrying out any reportable*
11 *transaction, and*

12 “(ii) *who directly or indirectly derives*
13 *gross income in excess of the threshold*
14 *amount (or such other amount as may be*
15 *prescribed by the Secretary) for such advice*
16 *or assistance.*

17 “(B) *THRESHOLD AMOUNT.—For purposes*
18 *of subparagraph (A), the threshold amount is—*

19 “(i) *\$50,000 in the case of a reportable*
20 *transaction substantially all of the tax bene-*
21 *fits from which are provided to natural per-*
22 *sons, and*

23 “(ii) *\$250,000 in any other case.*

1 “(2) *REPORTABLE TRANSACTION.*—*The term ‘re-*
2 *portable transaction’ has the meaning given to such*
3 *term by section 6707A(c).*

4 “(c) *REGULATIONS.*—*The Secretary may prescribe reg-*
5 *ulations which provide—*

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

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

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

14 (b) *CONFORMING AMENDMENTS.*—

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

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

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

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

23 “(a) *IN GENERAL.*—*Each material advisor (as defined*
24 *in section 6111) with respect to any reportable transaction*
25 *(as defined in section 6707A(c)) shall (whether or not re-*

1 *quired to file a return under section 6111 with respect to*
2 *such transaction) maintain (in such manner as the Sec-*
3 *retary may by regulations prescribe) a list—*

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

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

9 *(3) Section 6112 is amended—*

10 *(A) by redesignating subsection (c) as sub-*
11 *section (b),*

12 *(B) by inserting “written” before “request”*
13 *in subsection (b)(1) (as so redesignated), and*

14 *(C) by striking “shall prescribe” in sub-*
15 *section (b)(2) (as so redesignated) and inserting*
16 *“may prescribe”.*

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

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

20 *(5)(A) The heading for section 6708 is amended*
21 *to read as follows:*

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

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

“Sec. 6708. Failure to maintain lists of advisees with respect to re-
portable transactions.”

7 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
8 **OF CONFIDENTIALITY.**—*Paragraph (1) of section 6112(b),*
9 *as redesignated by subsection (b), is amended by adding*
10 *at the end the following new flush sentence:*

11 *“For purposes of this section, the identity of any per-*
12 *son on such list shall not be privileged.”.*

13 (d) **EFFECTIVE DATE.**—

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

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

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

3 **SEC. 3006. FAILURE TO FURNISH INFORMATION REGARD-**
4 **ING REPORTABLE TRANSACTIONS.**

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

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

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

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

15 *“(2) files false or incomplete information with*
16 *the Secretary with respect to such transaction,*

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

19 **“(b) AMOUNT OF PENALTY.—**

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

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

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

3 *“(A) \$200,000, or*

4 *“(B) 50 percent of the gross income derived*
5 *by such person with respect to aid, assistance, or*
6 *advice which is provided with respect to the list-*
7 *ed transaction before the date the return is filed*
8 *under section 6111.*

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

12 *“(c) RESCISSION AUTHORITY.—The provisions of sec-*
13 *tion 6707A(d) (relating to authority of Commissioner to re-*
14 *scind penalty) shall apply to any penalty imposed under*
15 *this section.*

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

20 *(b) CLERICAL AMENDMENT.—The item relating to sec-*
21 *tion 6707 in the table of sections for part I of subchapter*
22 *B of chapter 68 is amended by striking “tax shelters” and*
23 *inserting “reportable transactions”.*

1 (c) *EFFECTIVE DATE.*—*The amendments made by this*
2 *section shall apply to returns the due date for which is after*
3 *the date of the enactment of this Act.*

4 **SEC. 3007. MODIFICATION OF PENALTY FOR FAILURE TO**
5 **MAINTAIN LISTS OF INVESTORS.**

6 (a) *IN GENERAL.*—*Subsection (a) of section 6708 is*
7 *amended to read as follows:*

8 “(a) *IMPOSITION OF PENALTY.*—

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

16 “(2) *REASONABLE CAUSE EXCEPTION.*—*No pen-*
17 *alty shall be imposed by paragraph (1) with respect*
18 *to the failure on any day if such failure is due to rea-*
19 *sonable cause.”.*

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

23 **SEC. 3008. PENALTY ON PROMOTERS OF TAX SHELTERS.**

24 (a) *PENALTY ON PROMOTING ABUSIVE TAX SHEL-*
25 *TERS.*—*Section 6700(a) is amended by adding at the end*

1 *the following new sentence: “Notwithstanding the first sen-*
2 *tence, if an activity with respect to which a penalty im-*
3 *posed under this subsection involves a statement described*
4 *in paragraph (2)(A), the amount of the penalty shall be*
5 *equal to 50 percent of the gross income derived (or to be*
6 *derived) from such activity by the person on which the pen-*
7 *alty is imposed.”*

8 **(b) EFFECTIVE DATE.**—*The amendment made by this*
9 *section shall apply to activities after the date of the enact-*
10 *ment of this Act.*

11 **SEC. 3009. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
12 **MENT PENALTY FOR NONREPORTABLE**
13 **TRANSACTIONS.**

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

17 **“(B) SPECIAL RULE FOR CORPORATIONS.**—
18 *In the case of a corporation other than an S cor-*
19 *poration or a personal holding company (as de-*
20 *fined in section 542), there is a substantial un-*
21 *derstatement of income tax for any taxable year*
22 *if the amount of the understatement for the tax-*
23 *able year exceeds the lesser of—*

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

4 “(ii) \$10,000,000.”

5 (b) *EFFECTIVE DATE.*—The amendment made by this
6 section shall apply to taxable years beginning after the date
7 of the enactment of this Act.

8 **SEC. 3010. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
9 **CONDUCT RELATED TO TAX SHELTERS AND**
10 **REPORTABLE TRANSACTIONS.**

11 (a) *IN GENERAL.*—Section 7408 (relating to action to
12 enjoin promoters of abusive tax shelters, etc.) is amended
13 by redesignating subsection (c) as subsection (d) and by
14 striking subsections (a) and (b) and inserting the following
15 new subsections:

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

1 *apart from any other action brought by the United States*
2 *against such person.*

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

5 “(1) *that the person has engaged in any specified*
6 *conduct, and*

7 “(2) *that injunctive relief is appropriate to pre-*
8 *vent recurrence of such conduct,*

9 *the court may enjoin such person from engaging in such*
10 *conduct or in any other activity subject to penalty under*
11 *this title.*

12 “(c) *SPECIFIED CONDUCT.*—*For purposes of this sec-*
13 *tion, the term ‘specified conduct’ means any action, or fail-*
14 *ure to take action, subject to penalty under section 6700,*
15 *6701, 6707, or 6708.”*

16 (b) *CONFORMING AMENDMENTS.*—

17 (1) *The heading for section 7408 is amended to*
18 *read as follows:*

19 “**SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
20 **LATED TO TAX SHELTERS AND REPORTABLE**
21 **TRANSACTIONS.”**

22 (2) *The table of sections for subchapter A of*
23 *chapter 76 is amended by striking the item relating*
24 *to section 7408 and inserting the following new item:*

“*Sec. 7408. Actions to enjoin specified conduct related to tax shelters and re-*
portable transactions.”

1 (c) *EFFECTIVE DATE.*—*The amendment made by this*
2 *section shall take effect on the day after the date of the en-*
3 *actment of this Act.*

4 **SEC. 3011. PENALTY ON FAILURE TO REPORT INTERESTS IN**
5 **FOREIGN FINANCIAL ACCOUNTS.**

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

8 “(5) *FOREIGN FINANCIAL AGENCY TRANSACTION*
9 *VIOLATION.*—

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

14 “(B) *AMOUNT OF PENALTY.*—

15 “(i) *IN GENERAL.*—*Except as provided*
16 *in subparagraph (C), the amount of any*
17 *civil penalty imposed under subparagraph*
18 *(A) shall not exceed \$5,000.*

19 “(ii) *REASONABLE CAUSE EXCEP-*
20 *TION.*—*No penalty shall be imposed under*
21 *subparagraph (A) with respect to any viola-*
22 *tion if—*

23 “(I) *such violation was due to*
24 *reasonable cause, and*

1 “(II) the amount of the trans-
2 action or the balance in the account at
3 the time of the transaction was prop-
4 erly reported.

5 “(C) WILLFUL VIOLATIONS.—In the case of
6 any person willfully violating, or willfully caus-
7 ing any violation of, any provision of section
8 5314—

9 “(i) the maximum penalty under sub-
10 paragraph (B)(i) shall be increased to the
11 greater of—

12 “(I) \$25,000, or

13 “(II) the amount (not exceeding
14 \$100,000) determined under subpara-
15 graph (D), and

16 “(ii) subparagraph (B)(i) shall not
17 apply.

18 “(D) AMOUNT.—The amount determined
19 under this subparagraph is—

20 “(i) in the case of a violation involving
21 a transaction, the amount of the trans-
22 action, or

23 “(ii) in the case of a violation involv-
24 ing a failure to report the existence of an
25 account or any identifying information re-

1 *quired to be provided with respect to an ac-*
2 *count, the balance in the account at the*
3 *time of the violation.”*

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

7 **SEC. 3012. REGULATION OF INDIVIDUALS PRACTICING BE-**
8 **FORE THE DEPARTMENT OF THE TREASURY.**

9 **(a) CENSURE; IMPOSITION OF PENALTY.**—

10 **(1) IN GENERAL.**—*Section 330(b) of title 31,*
11 *United States Code, is amended—*

12 **(A)** *by inserting “, or censure,” after “De-*
13 *partment”, and*

14 **(B)** *by adding at the end the following new*
15 *flush sentence:*

16 *“The Secretary may impose a monetary penalty on any*
17 *representative described in the preceding sentence. If the*
18 *representative was acting on behalf of an employer or any*
19 *firm or other entity in connection with the conduct giving*
20 *rise to such penalty, the Secretary may impose a monetary*
21 *penalty on such employer, firm, or entity if it knew, or*
22 *reasonably should have known, of such conduct. Such pen-*
23 *alty shall not exceed the gross income derived (or to be de-*
24 *rived) from the conduct giving rise to the penalty. Any such*
25 *penalty imposed on an individual may be in addition to,*

1 *or in lieu of, any suspension, disbarment, or censure of such*
2 *individual.”*

3 (2) *EFFECTIVE DATE.*—*The amendments made*
4 *by this subsection shall apply to actions taken after*
5 *the date of the enactment of this Act.*

6 (b) *TAX SHELTER OPINIONS, ETC.*—*Section 330 of*
7 *such title 31 is amended by adding at the end the following*
8 *new subsection:*

9 “(d) *Nothing in this section or in any other provision*
10 *of law shall be construed to limit the authority of the Sec-*
11 *retary of the Treasury to impose standards applicable to*
12 *the rendering of written advice with respect to any entity,*
13 *transaction plan or arrangement, or other plan or arrange-*
14 *ment, which is of a type which the Secretary determines*
15 *as having a potential for tax avoidance or evasion.”*

16 ***Subtitle B—Other Provisions***

17 ***SEC. 3021. TREATMENT OF STRIPPED INTERESTS IN BOND*** 18 ***AND PREFERRED STOCK FUNDS, ETC.***

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

23 “(f) *TREATMENT OF STRIPPED INTERESTS IN BOND*
24 *AND PREFERRED STOCK FUNDS, ETC.*—*In the case of an*
25 *account or entity substantially all of the assets of which*

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

7 *(b) CROSS REFERENCE.—Subsection (e) of section 305*
 8 *is amended by adding at the end the following new para-*
 9 *graph:*

10 *“(7) CROSS REFERENCE.—*

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

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

14 **SEC. 3022. MINIMUM HOLDING PERIOD FOR FOREIGN TAX**

15 **CREDIT ON WITHHOLDING TAXES ON INCOME**

16 **OTHER THAN DIVIDENDS.**

17 *(a) IN GENERAL.—Section 901 is amended by redesign-*
 18 *ating subsection (l) as subsection (m) and by inserting*
 19 *after subsection (k) the following new subsection:*

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

23 *“(1) IN GENERAL.—In no event shall a credit be*
 24 *allowed under subsection (a) for any withholding tax*

1 *(as defined in subsection (k)) on any item of income*
2 *or gain with respect to any property if—*

3 *“(A) such property is held by the recipient*
4 *of the item for 15 days or less during the 30-day*
5 *period beginning on the date which is 15 days*
6 *before the date on which the right to receive pay-*
7 *ment of such item arises, or*

8 *“(B) to the extent that the recipient of the*
9 *item is under an obligation (whether pursuant to*
10 *a short sale or otherwise) to make related pay-*
11 *ments with respect to positions in substantially*
12 *similar or related property.*

13 *This paragraph shall not apply to any dividend to*
14 *which subsection (k) applies.*

15 *“(2) EXCEPTION FOR TAXES PAID BY DEAL-*
16 *ERS.—*

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

22 *“(B) QUALIFIED TAX.—For purposes of sub-*
23 *paragraph (A), the term ‘qualified tax’ means a*
24 *tax paid to a foreign country (other than the for-*

1 *eign country referred to in subparagraph (A))*
2 *if—*

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

7 “(ii) *such country allows a credit*
8 *against its net basis tax for the full amount*
9 *of the tax paid to such other foreign coun-*
10 *try.*

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

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

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

21 “(D) *REGULATIONS.—The Secretary may*
22 *prescribe such regulations as may be appropriate*
23 *to carry out this paragraph, including regula-*
24 *tions to prevent the abuse of the exception pro-*

1 *vided by this paragraph and to treat other taxes*
2 *as qualified taxes.*

3 “(3) *EXCEPTIONS.*—*The Secretary may by regu-*
4 *lation provide that paragraph (1) shall not apply to*
5 *property where the Secretary determines that the ap-*
6 *plication of paragraph (1) to such property is not*
7 *necessary to carry out the purposes of this subsection.*

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

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

15 (b) *CONFORMING AMENDMENT.*—*The heading of sub-*
16 *section (k) of section 901 is amended by inserting “ON DIVI-*
17 *DENDS” after “TAXES”.*

18 (c) *EFFECTIVE DATE.*—*The amendments made by this*
19 *section shall apply to amounts paid or accrued more than*
20 *30 days after the date of the enactment of this Act.*

21 **SEC. 3023. DISALLOWANCE OF CERTAIN PARTNERSHIP**
22 **LOSS TRANSFERS.**

23 (a) *TREATMENT OF CONTRIBUTED PROPERTY WITH*
24 *BUILT-IN LOSS.*—*Paragraph (1) of section 704(c) is*
25 *amended by striking “and” at the end of subparagraph (A),*

1 *by striking the period at the end of subparagraph (B) and*
2 *inserting “, and”, and by adding at the end the following:*

3 *“(C) if any property so contributed has a*
4 *built-in loss—*

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

9 *“(ii) except as provided in regulations,*
10 *in determining the amount of items allo-*
11 *cated to other partners, the basis of the con-*
12 *tributed property in the hands of the part-*
13 *nership shall be treated as being equal to its*
14 *fair market value at the time of contribu-*
15 *tion.*

16 *For purposes of subparagraph (C), the term ‘built-in*
17 *loss’ means the excess of the adjusted basis of the*
18 *property (determined without regard to subparagraph*
19 *(C)(ii)) over its fair market value at the time of con-*
20 *tribution.”*

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

24 *(1) ADJUSTMENT REQUIRED.—Subsection (a) of*
25 *section 743 (relating to optional adjustment to basis*

1 of partnership property) is amended by inserting be-
2 fore the period “or unless the partnership has a sub-
3 stantial built-in loss immediately after such transfer”.

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

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

11 “(d) *SUBSTANTIAL BUILT-IN LOSS.*—

12 “(1) *IN GENERAL.*—For purposes of this section,
13 a partnership has a substantial built-in loss with re-
14 spect to a transfer of an interest in a partnership if
15 the partnership’s adjusted basis in the partnership
16 property exceeds by more than \$250,000 the fair mar-
17 ket value of such property.

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

25 (4) *CLERICAL AMENDMENTS.*—

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

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

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

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

10 (c) *ADJUSTMENT TO BASIS OF UNDISTRIBUTED PART-*
11 *NERSHIP PROPERTY IF THERE IS SUBSTANTIAL BASIS RE-*
12 *DUCTION.—*

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

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

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

24 *“(d) SUBSTANTIAL BASIS REDUCTION.—*

1 “(1) *IN GENERAL.*—For purposes of this section,
 2 there is a substantial basis reduction with respect to
 3 a distribution if the sum of the amounts described in
 4 subparagraphs (A) and (B) of subsection (b)(2) ex-
 5 ceeds \$250,000.

6 “(2) *REGULATIONS.*—

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

7 “(4) *CLERICAL AMENDMENTS.*—

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

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

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

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

18 “(d) *EFFECTIVE DATES.*—

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

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

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

7 **SEC. 3024. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
8 **STOCK HELD BY PARTNERSHIP IN COR-**
9 **PORATE PARTNER.**

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

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

16 “(1) *no allocation may be made to stock in a*
17 *corporation (or any person related (within the mean-*
18 *ing of sections 267(b) and 707(b)(1)) to such corpora-*
19 *tion) which is a partner in the partnership, and*

20 “(2) *any amount not allocable to stock by reason*
21 *of paragraph (1) shall be allocated under subsection*
22 *(a) to other partnership property.*

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

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

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

6 **SEC. 3025. REPEAL OF SPECIAL RULES FOR FASITS.**

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

10 (b) *CONFORMING AMENDMENTS.*—

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

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

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

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

23 (5)(A) *Section 860G(a)(1) is amended by adding*
24 *at the end the following new sentence: “An interest*
25 *shall not fail to qualify as a regular interest solely be-*

1 *cause the specified principal amount of the regular*
2 *interest (or the amount of interest accrued on the reg-*
3 *ular interest) can be reduced as a result of the non-*
4 *occurrence of 1 or more contingent payments with re-*
5 *spect to any reverse mortgage loan held by the*
6 *REMIC if, on the startup day for the REMIC, the*
7 *sponsor reasonably believes that all principal and in-*
8 *terest due under the regular interest will be paid at*
9 *or prior to the liquidation of the REMIC.”.*

10 *(B) The last sentence of section 860G(a)(3) is*
11 *amended by inserting “, and any reverse mortgage*
12 *loan (and each balance increase on such loan meeting*
13 *the requirements of subparagraph (A)(iii)) shall be*
14 *treated as an obligation secured by an interest in real*
15 *property” before the period at the end.*

16 *(6) Paragraph (3) of section 860G(a) is amended*
17 *by adding “and” at the end of subparagraph (B), by*
18 *striking “, and” at the end of subparagraph (C) and*
19 *inserting a period, and by striking subparagraph (D).*

20 *(7) Section 860G(a)(3) is amended by adding at*
21 *the end the following new sentence: “For purposes of*
22 *subparagraph (A), if more than 50 percent of the obli-*
23 *gations transferred to, or purchased by, the REMIC*
24 *are originated by the United States or any State (or*
25 *any political subdivision, agency, or instrumentality*

1 of the United States or any State) and are prin-
2 cipally secured by an interest in real property, then
3 each obligation transferred to, or purchased by, the
4 REMIC shall be treated as secured by an interest in
5 real property.”.

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

10 “(iii) represents an increase in the
11 principal amount under the original terms
12 of an obligation described in clause (i) or
13 (ii) if—

14 “(I) such increase in the balance
15 is attributable to an advance made to
16 the obligor pursuant to the original
17 terms of the obligation,

18 “(II) such increase in the balance
19 occurs after the startup day, and

20 “(III) such increase in the balance
21 is purchased by the REMIC pursuant
22 to a fixed price contract in effect on
23 the startup day.”.

24 (B) Section 860G(a)(7)(B) is amended to read as
25 follows:

1 “(B) *QUALIFIED RESERVE FUND.*—For pur-
2 poses of subparagraph (A), the term ‘qualified
3 reserve fund’ means any reasonably required re-
4 serve to—

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

10 “(ii) provide a source of funds for the
11 purchase of obligations described in clause
12 (ii) or (iii) of paragraph (3)(A).

13 *The aggregate fair market value of the assets held*
14 *in any such reserve shall not exceed 50 percent*
15 *of the aggregate fair market value of all of the*
16 *assets of the REMIC on the startup day, and the*
17 *amount of any such reserve shall be promptly*
18 *and appropriately reduced to the extent the*
19 *amount held in such reserve is no longer reason-*
20 *ably required for purposes specified in clause (i)*
21 *or (ii) of paragraph (3)(A).”.*

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

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

3 “For purposes of clause (iii), the Secretary shall
4 prescribe regulations permitting the use of a cur-
5 rent prepayment assumption, determined as of
6 the close of the accrual period (or such other time
7 as the Secretary may prescribe during the tax-
8 able year in which the accrual period ends).”.

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

13 (12) The table of parts for subchapter M of chap-
14 ter 1 is amended by striking the item relating to part
15 V.

16 (c) *EFFECTIVE DATE.*—

17 (1) *IN GENERAL.*—Except as provided in para-
18 graph (2), the amendments made by this section shall
19 apply to taxable years beginning after December 31,
20 2003.

21 (2) *EXCEPTION FOR EXISTING FASITS.*—

22 (A) *IN GENERAL.*—Paragraph (1) shall not
23 apply to any *FASIT* in existence on the date of
24 the enactment of this Act to the extent that reg-
25 ular interests issued by the *FASIT* before such

1 date continue to remain outstanding in accord-
2 ance with the original terms of issuance.

3 (B) *TRANSFER OF ADDITIONAL ASSETS NOT*
4 *PERMITTED.*—*Except as provided in regulations*
5 *prescribed by the Secretary of the Treasury or*
6 *the Secretary’s delegate, subparagraph (A) shall*
7 *cease to apply as of the earliest date after the*
8 *date of the enactment of this Act that any prop-*
9 *erty is transferred to the FASIT.*

10 **SEC. 3026. LIMITATION ON TRANSFER OF BUILT-IN LOSSES**
11 **ON REMIC RESIDUALS.**

12 (a) *IN GENERAL.*—*Section 362 (relating to basis to*
13 *corporations) is amended by adding at the end the following*
14 *new subsection:*

15 “(e) *LIMITATION ON TRANSFER OF BUILT-IN LOSSES*
16 *ON REMIC RESIDUALS IN SECTION 351 TRANSACTIONS.*—
17 *If—*

18 “(1) *a residual interest (as defined in section*
19 *860G(a)(2)) in a REMIC is transferred in any trans-*
20 *action which is described in subsection (a), and*

21 “(2) *the transferee’s adjusted basis in such resid-*
22 *ual interest would (but for this paragraph) exceed its*
23 *fair market value immediately after such transaction,*
24 *then, notwithstanding subsection (a), the transferee’s ad-*
25 *justed basis in such residual interest shall not exceed its*

1 *fair market value (whether or not greater than zero) imme-*
2 *diately after such transaction.”*

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

6 **SEC. 3027. CLARIFICATION OF BANKING BUSINESS FOR**
7 **PURPOSES OF DETERMINING INVESTMENT**
8 **OF EARNINGS IN UNITED STATES PROPERTY.**

9 (a) *IN GENERAL.*—*Subparagraph (A) of section*
10 *956(c)(2) is amended to read as follows:*

11 “(A) *obligations of the United States,*
12 *money, or deposits with any corporation with re-*
13 *spect to which a bank holding company (within*
14 *the meaning of section 2(a) of the Bank Holding*
15 *Company Act of 1956 (12 U.S.C. 1841(a)) or fi-*
16 *ancial holding company (within the meaning of*
17 *section 2(p) of such Act) owns directly or indi-*
18 *rectly more than 80 percent by vote or value of*
19 *the stock of such corporation;”.*

20 (b) *EFFECTIVE DATE.*—*The amendment made by this*
21 *section shall take effect on the date of the enactment of this*
22 *Act.*

1 **SEC. 3028. MODIFICATIONS RELATED TO CERTAIN SMALL**
2 **INSURANCE COMPANIES.**

3 (a) *EXEMPTION FOR SMALL PROPERTY AND CASUALTY*
4 *INSURANCE COMPANIES.*—

5 (1) *IN GENERAL.*—Section 501(c)(15)(A) is
6 amended to read as follows:

7 “(A) Insurance companies (as defined in
8 section 816(a)) other than life (including inter-
9 insurers and reciprocal underwriters) if—

10 “(i) the gross receipts for the taxable
11 year do not exceed \$600,000, and

12 “(ii) more than 50 percent of such
13 gross receipts consist of premiums.”.

14 (2) *CONTROLLED GROUP RULE.*—Section
15 501(c)(15)(C) is amended by inserting “, except that
16 in applying section 1563 for purposes of section
17 831(b)(2)(B)(ii), subparagraphs (B) and (C) of sec-
18 tion 1563(b)(2) shall be disregarded” before the period
19 at the end.

20 (3) *CONFORMING AMENDMENT.*—Clause (i) of
21 section 831(b)(2)(A) is amended by striking “exceed
22 \$350,000 but”.

23 (b) *ALTERNATIVE TAX FOR CERTAIN SMALL INSUR-*
24 *ANCE COMPANIES.*—

1 (1) *INCREASED LIMITATION.*—Clause (i) of sec-
2 tion 831(b)(2)(A) is amended by striking
3 “\$1,200,000” and inserting “\$1,890,000”.

4 (2) *INFLATION ADJUSTMENT.*—Paragraph (2) of
5 section 831(b) is amended by adding at the end the
6 following new subparagraph:

7 “(C) *INFLATION ADJUSTMENT.*—In the case
8 of any taxable year beginning in a calendar year
9 after 2004, the \$1,890,000 amount in subpara-
10 graph (A) shall be increased by an amount equal
11 to—

12 “(i) \$1,890,000, multiplied by

13 “(ii) the cost-of-living adjustment de-
14 termined under section 1(f)(3) for such cal-
15 endar year by substituting ‘calendar year
16 2003’ for ‘calendar year 1992’ in subpara-
17 graph (B) thereof.

18 If the amount as adjusted under the preceding
19 sentence is not a multiple of \$1,000, such
20 amount shall be rounded to the next lowest mul-
21 tiple of \$1,000.”.

22 (c) *EFFECTIVE DATE.*—The amendments made by this
23 section shall apply to taxable years beginning after Decem-
24 ber 31, 2003.

1 **SEC. 3029. DEFINITION OF INSURANCE COMPANY FOR SEC-**
2 **TION 831.**

3 (a) *IN GENERAL.*—Section 831 is amended by redesignig-
4 nating subsection (c) as subsection (d) and by inserting
5 after subsection (b) the following new subsection:

6 “(c) *INSURANCE COMPANY DEFINED.*—For purposes of
7 this section, the term ‘insurance company’ has the meaning
8 given to such term by section 816(a).”

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

12 **SEC. 3030. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
13 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
14 **CLOSED REPORTABLE TRANSACTIONS.**

15 (a) *IN GENERAL.*—Section 163 (relating to deduction
16 for interest) is amended by redesignating subsection (m) as
17 subsection (n) and by inserting after subsection (l) the fol-
18 lowing new subsection:

19 “(m) *INTEREST ON UNPAID TAXES ATTRIBUTABLE TO*
20 *NONDISCLOSED REPORTABLE TRANSACTIONS.*—No deduc-
21 tion shall be allowed under this chapter for any interest
22 paid or accrued under section 6601 on any underpayment
23 of tax which is attributable to the portion of any reportable
24 transaction understatement (as defined in section
25 6662A(b)) with respect to which the requirement of section
26 6664(d)(2)(A) is not met.”

1 (b) *EFFECTIVE DATE.*—*The amendments made by this*
2 *section shall apply to transactions in taxable years begin-*
3 *ning after the date of the enactment of this Act.*

4 **SEC. 3031. CLARIFICATION OF RULES FOR PAYMENT OF ES-**
5 **TIMATED TAX FOR CERTAIN DEEMED ASSET**
6 **SALES.**

7 (a) *IN GENERAL.*—*Paragraph (13) of section 338(h)*
8 *(relating to tax on deemed sale not taken into account for*
9 *estimated tax purposes) is amended by adding at the end*
10 *the following: “The preceding sentence shall not apply with*
11 *respect to a qualified stock purchase for which an election*
12 *is made under paragraph (10).”.*

13 (b) *EFFECTIVE DATE.*—*The amendment made by sub-*
14 *section (a) shall apply to transactions occurring after the*
15 *date of the enactment of this Act.*

16 **SEC. 3032. RECOGNITION OF GAIN FROM THE SALE OF A**
17 **PRINCIPAL RESIDENCE ACQUIRED IN A LIKE-**
18 **KIND EXCHANGE WITHIN 5 YEARS OF SALE.**

19 (a) *IN GENERAL.*—*Section 121(d) (relating to special*
20 *rules for exclusion of gain from sale of principal residence)*
21 *is amended by adding at the end the following new para-*
22 *graph:*

23 “(10) *PROPERTY ACQUIRED IN LIKE-KIND EX-*
24 *CHANGE.*—*If a taxpayer acquired property in an ex-*
25 *change to which section 1031 applied, subsection (a)*

1 *shall not apply to the sale or exchange of such prop-*
 2 *erty if it occurs during the 5-year period beginning*
 3 *with the date of the acquisition of such property.”.*

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

7 ***SEC. 3033. PREVENTION OF MISMATCHING OF INTEREST***
 8 ***AND ORIGINAL ISSUE DISCOUNT DEDUC-***
 9 ***TIONS AND INCOME INCLUSIONS IN TRANS-***
 10 ***ACTIONS WITH RELATED FOREIGN PERSONS.***

11 ***(a) ORIGINAL ISSUE DISCOUNT.***—*Section 163(e)(3)*
 12 *(relating to special rule for original issue discount on obli-*
 13 *gation held by related foreign person) is amended by redes-*
 14 *ignating subparagraph (B) as subparagraph (C) and by in-*
 15 *serting after subparagraph (A) the following new subpara-*
 16 *graph:*

17 ***“(B) SPECIAL RULE FOR CERTAIN FOREIGN***
 18 ***ENTITIES.***—

19 ***“(i) IN GENERAL.***—*In the case of any*
 20 *debt instrument having original issue dis-*
 21 *count which is held by a related foreign per-*
 22 *son which is a foreign personal holding*
 23 *company (as defined in section 552), a con-*
 24 *trolled foreign corporation (as defined in*
 25 *section 957), or a passive foreign investment*

1 company (as defined in section 1297), a de-
2 duction shall be allowable to the issuer with
3 respect to such original issue discount for
4 any taxable year before the taxable year in
5 which paid only to the extent such original
6 issue discount is included during such prior
7 taxable year in the gross income of a United
8 States person who owns (within the mean-
9 ing of section 958(a)) stock in such corpora-
10 tion.

11 “(ii) *SECRETARIAL AUTHORITY.*—The
12 Secretary may by regulation exempt trans-
13 actions from the application of clause (i),
14 including any transaction which is entered
15 into by a payor in the ordinary course of
16 a trade or business in which the payor is
17 predominantly engaged.”.

18 (b) *INTEREST AND OTHER DEDUCTIBLE AMOUNTS.*—

19 Section 267(a)(3) is amended—

20 (1) by striking “The Secretary” and inserting:

21 “(A) *IN GENERAL.*—The Secretary”, and

22 (2) by adding at the end the following new sub-
23 paragraph:

24 “(B) *SPECIAL RULE FOR CERTAIN FOREIGN*

25 *ENTITIES.*—

1 “(i) *IN GENERAL.*—Notwithstanding
2 *subparagraph (A), in the case of any*
3 *amount payable to a foreign personal hold-*
4 *ing company (as defined in section 552), a*
5 *controlled foreign corporation (as defined in*
6 *section 957), or a passive foreign investment*
7 *company (as defined in section 1297), a de-*
8 *duction shall be allowable to the payor with*
9 *respect to such amount for any taxable year*
10 *before the taxable year in which paid only*
11 *to the extent such amount is included dur-*
12 *ing such prior taxable year in the gross in-*
13 *come of a United States person who owns*
14 *(within the meaning of section 958(a)) stock*
15 *in such corporation.*

16 “(ii) *SECRETARIAL AUTHORITY.*—The
17 *Secretary may by regulation exempt trans-*
18 *actions from the application of clause (i),*
19 *including any transaction which is entered*
20 *into by a payor in the ordinary course of*
21 *a trade or business in which the payor is*
22 *predominantly engaged and in which the*
23 *payment of the accrued amounts occurs*
24 *within 8¹/₂ months after accrual or within*

1 *such other period as the Secretary may pre-*
2 *scribe.”.*

3 (c) *EFFECTIVE DATE.*—*The amendments made by this*
4 *section shall apply to payments accrued on or after the date*
5 *of the enactment of this Act.*

6 **SEC. 3034. EXCLUSION FROM GROSS INCOME FOR INTER-**
7 **EST ON OVERPAYMENTS OF INCOME TAX BY**
8 **INDIVIDUALS.**

9 (a) *IN GENERAL.*—*Part III of subchapter B of chapter*
10 *1 (relating to items specifically excluded from gross income)*
11 *is amended by inserting after section 139A the following*
12 *new section:*

13 **“SEC. 139B. EXCLUSION FROM GROSS INCOME FOR INTER-**
14 **EST ON OVERPAYMENTS OF INCOME TAX BY**
15 **INDIVIDUALS.**

16 “(a) *IN GENERAL.*—*In the case of an individual, gross*
17 *income shall not include interest paid under section 6611*
18 *on any overpayment of tax imposed by this subtitle.*

19 “(b) *EXCEPTION.*—*Subsection (a) shall not apply in*
20 *the case of a failure to claim items resulting in the overpay-*
21 *ment on the original return if the Secretary determines that*
22 *the principal purpose of such failure is to take advantage*
23 *of subsection (a).*

24 “(c) *SPECIAL RULE FOR DETERMINING MODIFIED AD-*
25 *JUSTED GROSS INCOME.*—*For purposes of this title, interest*

1 *not included in gross income under subsection (a) shall not*
 2 *be treated as interest which is exempt from tax for purposes*
 3 *of sections 32(i)(2)(B) and 6012(d) or any computation in*
 4 *which interest exempt from tax under this title is added*
 5 *to adjusted gross income.”.*

6 (b) *CLERICAL AMENDMENT.—The table of sections for*
 7 *part III of subchapter B of chapter 1 is amended by insert-*
 8 *ing after the item relating to section 139A the following*
 9 *new item:*

“Sec. 139B. Exclusion from gross income for interest on overpay-
ments of income tax by individuals.”.

10 (c) *EFFECTIVE DATE.—The amendments made by this*
 11 *section shall apply to interest received in calendar years*
 12 *beginning after the date of the enactment of this Act.*

13 **SEC. 3035. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
 14 **TEREST ON POTENTIAL UNDERPAYMENTS.**

15 (a) *IN GENERAL.—Subchapter A of chapter 67 (relat-*
 16 *ing to interest on underpayments) is amended by adding*
 17 *at the end the following new section:*

18 **“SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
 19 **TEREST ON POTENTIAL UNDERPAYMENTS,**
 20 **ETC.**

21 *“(a) AUTHORITY TO MAKE DEPOSITS OTHER THAN*
 22 *AS PAYMENT OF TAX.—A taxpayer may make a cash de-*
 23 *posit with the Secretary which may be used by the Sec-*
 24 *retary to pay any tax imposed under subtitle A or B or*

1 *chapter 41, 42, 43, or 44 which has not been assessed at*
2 *the time of the deposit. Such a deposit shall be made in*
3 *such manner as the Secretary shall prescribe.*

4 “(b) *NO INTEREST IMPOSED.*—*To the extent that such*
5 *deposit is used by the Secretary to pay tax, for purposes*
6 *of section 6601 (relating to interest on underpayments), the*
7 *tax shall be treated as paid when the deposit is made.*

8 “(c) *RETURN OF DEPOSIT.*—*Except in a case where*
9 *the Secretary determines that collection of tax is in jeop-*
10 *ardy, the Secretary shall return to the taxpayer any*
11 *amount of the deposit (to the extent not used for a payment*
12 *of tax) which the taxpayer requests in writing.*

13 “(d) *PAYMENT OF INTEREST.*—

14 “(1) *IN GENERAL.*—*For purposes of section 6611*
15 *(relating to interest on overpayments), a deposit*
16 *which is returned to a taxpayer shall be treated as a*
17 *payment of tax for any period to the extent (and only*
18 *to the extent) attributable to a disputable tax for such*
19 *period. Under regulations prescribed by the Secretary,*
20 *rules similar to the rules of section 6611(b)(2) shall*
21 *apply.*

22 “(2) *DISPUTABLE TAX.*—

23 “(A) *IN GENERAL.*—*For purposes of this*
24 *section, the term ‘disputable tax’ means the*
25 *amount of tax specified at the time of the deposit*

1 *as the taxpayer’s reasonable estimate of the max-*
2 *imum amount of any tax attributable to disput-*
3 *able items.*

4 “(B) *SAFE HARBOR BASED ON 30-DAY LET-*
5 *TER.—In the case of a taxpayer who has been*
6 *issued a 30-day letter, the maximum amount of*
7 *tax under subparagraph (A) shall not be less*
8 *than the amount of the proposed deficiency speci-*
9 *fied in such letter.*

10 “(3) *OTHER DEFINITIONS.—For purposes of*
11 *paragraph (2)—*

12 “(A) *DISPUTABLE ITEM.—The term ‘disput-*
13 *able item’ means any item of income, gain, loss,*
14 *deduction, or credit if the taxpayer—*

15 “(i) *has a reasonable basis for its*
16 *treatment of such item, and*

17 “(ii) *reasonably believes that the Sec-*
18 *retary also has a reasonable basis for dis-*
19 *allowing the taxpayer’s treatment of such*
20 *item.*

21 “(B) *30-DAY LETTER.—The term ‘30-day*
22 *letter’ means the first letter of proposed defi-*
23 *ciency which allows the taxpayer an opportunity*
24 *for administrative review in the Internal Rev-*
25 *enue Service Office of Appeals.*

1 “(4) *RATE OF INTEREST.*—*The rate of interest*
2 *allowable under this subsection shall be the Federal*
3 *short-term rate determined under section 6621(b),*
4 *compounded daily.*

5 “(e) *USE OF DEPOSITS.*—

6 “(1) *PAYMENT OF TAX.*—*Except as otherwise*
7 *provided by the taxpayer, deposits shall be treated as*
8 *used for the payment of tax in the order deposited.*

9 “(2) *RETURNS OF DEPOSITS.*—*Deposits shall be*
10 *treated as returned to the taxpayer on a last-in, first-*
11 *out basis.”.*

12 “(b) *CLERICAL AMENDMENT.*—*The table of sections for*
13 *subchapter A of chapter 67 is amended by adding at the*
14 *end the following new item:*

“Sec. 6603. Deposits made to suspend running of interest on poten-
tial underpayments, etc.”.

15 “(c) *EFFECTIVE DATE.*—

16 “(1) *IN GENERAL.*—*The amendments made by*
17 *this section shall apply to deposits made after the*
18 *date of the enactment of this Act.*

19 “(2) *COORDINATION WITH DEPOSITS MADE UNDER*
20 *REVENUE PROCEDURE 84–58.*—*In the case of an*
21 *amount held by the Secretary of the Treasury or his*
22 *delegate on the date of the enactment of this Act as*
23 *a deposit in the nature of a cash bond deposit pursu-*
24 *ant to Revenue Procedure 84–58, the date that the*

1 *YEARS.*—*In the case of an agreement entered into by the*
2 *Secretary under subsection (a) for partial collection of a*
3 *tax liability, the Secretary shall review the agreement at*
4 *least once every 2 years.”.*

5 *(c) EFFECTIVE DATE.*—*The amendments made by this*
6 *section shall apply to agreements entered into on or after*
7 *the date of the enactment of this Act.*

8 **SEC. 3037. EXTENSION OF IRS USER FEES.**

9 *(a) IN GENERAL.*—*Section 7528(c) (relating to termi-*
10 *nation) is amended by striking “December 31, 2004” and*
11 *inserting “September 30, 2013”.*

12 *(b) EFFECTIVE DATE.*—*The amendment made by this*
13 *section shall apply to requests after the date of the enact-*
14 *ment of this Act.*

15 **TITLE IV—TRADE ENHANCE-**
16 **MENT AND COMPLIANCE PRO-**
17 **VISIONS**

18 **SEC. 4001. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL**

19 **INCOME.**

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

21 *(b) CONFORMING AMENDMENTS.*—

22 *(1) Subpart E of part III of subchapter N of*
23 *chapter 1 (relating to qualifying foreign trade in-*
24 *come) is hereby repealed.*

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

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

6 (c) *EFFECTIVE DATE.—Except as provided in sub-*
7 *section (d), the amendments made by this section shall*
8 *apply to transactions after December 31, 2003.*

9 (d) *TRANSITIONAL RULE FOR 2004, 2005, AND 2006.—*

10 (1) *IN GENERAL.—In the case of transactions*
11 *during 2004, 2005, or 2006, the amount includible in*
12 *gross income by reason of the amendments made by*
13 *this section shall not exceed the applicable percentage*
14 *of the amount which would have been so included but*
15 *for this subsection.*

16 (2) *APPLICABLE PERCENTAGE.—For purposes of*
17 *paragraph (1), the applicable percentage shall be as*
18 *follows:*

19 (A) *For 2004, the applicable percentage*
20 *shall be 20 percent.*

21 (B) *For 2005, the applicable percentage*
22 *shall be 20 percent.*

23 (C) *For 2006, the applicable percentage*
24 *shall be 40 percent.*

1 (e) *REVOCATION OF ELECTION TO BE TREATED AS*
2 *DOMESTIC CORPORATION.*—*If, during the 1-year period be-*
3 *ginning on the date of the enactment of this Act, a corpora-*
4 *tion for which an election is in effect under section 943(e)*
5 *of the Internal Revenue Code of 1986 revokes such election,*
6 *no gain or loss shall be recognized with respect to property*
7 *treated as transferred under clause (ii) of section*
8 *943(e)(4)(B) of such Code to the extent such property—*

9 (1) *was treated as transferred under clause (i)*
10 *thereof, or*

11 (2) *was acquired during a taxable year to which*
12 *such election applies and before May 1, 2003, in the*
13 *ordinary course of its trade or business.*

14 *The Secretary of the Treasury (or such Secretary's delegate)*
15 *may prescribe such regulations as may be necessary to pre-*
16 *vent the abuse of the purposes of this subsection.*

17 (f) *BINDING CONTRACTS.*—*The amendments made by*
18 *this section shall not apply to any transaction in the ordi-*
19 *nary course of a trade or business which occurs pursuant*
20 *to a binding contract—*

21 (1) *which is between the taxpayer and a person*
22 *who is not a related person (as defined in section*
23 *943(b)(3) of such Code, as in effect on the day before*
24 *the date of the enactment of this Act), and*

1 (2) which is in effect on January 14, 2002, and
2 at all times thereafter.

3 For purposes of this subsection, a binding contract shall in-
4 clude a purchase option, renewal option, or replacement op-
5 tion which is included in such contract and which is en-
6 forceable against the seller or lessor.

7 **SEC. 4002. COBRA FEES.**

8 (a) *USE OF MERCHANDISE PROCESSING FEE.*—Sec-
9 tion 13031(f) of the Consolidated Omnibus Budget Rec-
10 onciliation Act of 1985 (19 U.S.C. 58c(f)) is amended—

11 (1) in paragraph (1), by aligning subparagraph
12 (B) with subparagraph (A); and

13 (2) in paragraph (2), by striking “commercial
14 operations” and all that follows through “processing.”
15 and inserting “customs revenue functions as defined
16 in section 415 of the Homeland Security Act of 2002
17 (other than functions performed by the Office of Inter-
18 national Affairs referred to in section 415(8) of that
19 Act), and for automation (including the Automation
20 Commercial Environment computer system), and for
21 no other purpose. To the extent that funds in the Cus-
22 toms User Fee Account are insufficient to pay the
23 costs of such customs revenue functions, customs du-
24 ties in an amount equal to the amount of such insuf-
25 ficiency shall be available, to the extent provided for

1 *in appropriations Acts, to pay the costs of such cus-*
2 *toms revenue functions in the amount of such insuffi-*
3 *ciency, and shall be available for no other purpose.*
4 *The provisions of the first and second sentences of this*
5 *paragraph specifying the purposes for which amounts*
6 *in the Customs User Fee Account may be made avail-*
7 *able shall not be superseded except by a provision of*
8 *law which specifically modifies or supersedes such*
9 *provisions.”.*

10 *(b) REIMBURSEMENT OF APPROPRIATIONS FROM*
11 *COBRA FEES.—Section 13031(f)(3) of the Consolidated*
12 *Omnibus Budget Reconciliation Act of 1985 (19 U.S.C.*
13 *58c(f)(3)) is amended by adding at the end the following:*

14 *“(E) Nothing in this paragraph shall be construed to*
15 *preclude the use of appropriated funds, from sources other*
16 *than the fees collected under subsection (a), to pay the costs*
17 *set forth in clauses (i), (ii), and (iii) of subparagraph (A).”.*

18 *(c) SENSE OF CONGRESS; EFFECTIVE PERIOD FOR*
19 *COLLECTING FEES; STANDARD FOR SETTING FEES.—*

20 *(1) SENSE OF CONGRESS.—The Congress finds*
21 *that—*

22 *(A) the fees set forth in paragraphs (1)*
23 *through (8) of subsection (a) of section 13031 of*
24 *the Consolidated Omnibus Budget Reconciliation*
25 *Act of 1985 have been reasonably related to the*

1 costs of providing customs services in connection
2 with the activities or items for which the fees
3 have been charged under such paragraphs; and

4 (B) the fees collected under such paragraphs
5 have not exceeded, in the aggregate, the amounts
6 paid for the costs described in subsection
7 (f)(3)(A) incurred in providing customs services
8 in connection with the activities or items for
9 which the fees were charged under such para-
10 graphs.

11 (2) *EFFECTIVE PERIOD; STANDARD FOR SETTING*
12 *FEES.*—Section 13031(j)(3) of the Consolidated Om-
13 nibus Budget Reconciliation Act of 1985 is amended
14 to read as follows:

15 “(3)(A) Fees may not be charged under paragraphs (9)
16 and (10) of subsection (a) after September 30, 2013.

17 “(B)(i) Subject to clause (ii), Fees may not be charged
18 under paragraphs (1) through (8) of subsection (a) after
19 September 30, 2013.

20 “(ii) In fiscal year 2006 and in each succeeding fiscal
21 year for which fees under paragraphs (1) through (8) of
22 subsection (a) are authorized—

23 “(I) the Secretary of the Treasury shall charge
24 fees under each such paragraph in amounts that are
25 reasonably related to the costs of providing customs

1 *services in connection with the activity or item for*
2 *which the fee is charged under such paragraph, except*
3 *that in no case may the fee charged under any such*
4 *paragraph exceed by more than 10 percent the*
5 *amount otherwise prescribed by such paragraph;*

6 *“(II) the amount of fees collected under such*
7 *paragraphs may not exceed, in the aggregate, the*
8 *amounts paid in that fiscal year for the costs de-*
9 *scribed in subsection (f)(3)(A) incurred in providing*
10 *customs services in connection with the activity or*
11 *item for which the fees are charged under such para-*
12 *graphs;*

13 *“(III) a fee may not be collected under any such*
14 *paragraph except to the extent such fee will be ex-*
15 *pended to pay the costs described in subsection*
16 *(f)(3)(A) incurred in providing customs services in*
17 *connection with the activity or item for which the fee*
18 *is charged under such paragraph; and*

19 *“(IV) any fee collected under any such para-*
20 *graph shall be available for expenditure only to pay*
21 *the costs described in subsection (f)(3)(A) incurred in*
22 *providing customs services in connection with the ac-*
23 *tivity or item for which the fee is charged under such*
24 *paragraph.”.*

1 (d) *CLERICAL AMENDMENTS.*—Section 13031 of the
2 *Consolidated Omnibus Budget Reconciliation Act of 1985*
3 *is amended—*

4 (1) *in subsection (a)(5)(B), by striking “\$1.75”*
5 *and inserting “\$1.75.”;*

6 (2) *in subsection (b)—*

7 (A) *in paragraph (1)(A), by aligning clause*
8 *(iii) with clause (ii);*

9 (B) *in paragraph (7), by striking “para-*
10 *graphs” and inserting “paragraph”; and*

11 (C) *in paragraph (9), by aligning subpara-*
12 *graph (B) with subparagraph (A); and*

13 (3) *in subsection (e)(2), by aligning subpara-*
14 *graph (B) with subparagraph (A).*

15 (e) *STUDY OF ALL FEES COLLECTED BY DEPARTMENT*
16 *OF HOMELAND SECURITY.*—*The Secretary of the Treasury*
17 *shall conduct a study of all the fees collected by the Depart-*
18 *ment of Homeland Security, and shall submit to the Con-*
19 *gress, not later than September 30, 2005, a report con-*
20 *taining the recommendations of the Secretary on—*

21 (1) *what fees should be eliminated;*

22 (2) *what the rate of fees retained should be; and*

23 (3) *any other recommendations with respect to*
24 *the fees that the Secretary considers appropriate.*

Union Calendar No. 226

108TH CONGRESS
1ST SESSION

H. R. 2896

[Report No. 108-393]

A BILL

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

NOVEMBER 21, 2003

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed