

108TH CONGRESS
1ST SESSION

S. 1436

To amend the Internal Revenue Code of 1986 to allow a deduction for State and local sales taxes in lieu of State and local income taxes, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 21, 2003

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

A BILL

To amend the Internal Revenue Code of 1986 to allow a deduction for State and local sales taxes in lieu of State and local income taxes, and for other purposes.

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

3 **SECTION 1. SHORT TITLE; REFERENCES; TABLE OF CON-**
4 **TENTS.**

5 (a) SHORT TITLE.—This Act may be cited as the
6 “Sales Tax Equity Act of 2003”.

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

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

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

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

TITLE I—SALES TAX DEDUCTION

Sec. 101. Deduction of State and local general sales taxes in lieu of State and local income taxes.

TITLE II—REVENUE PROVISIONS

Subtitle A—Provisions Designed To Curtail Tax Shelters

- Sec. 201. Clarification of economic substance doctrine.
- Sec. 202. Penalty for failing to disclose reportable transaction.
- Sec. 203. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.
- Sec. 204. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 205. Modifications of substantial understatement penalty for nonreportable transactions.
- Sec. 206. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
- Sec. 207. Disclosure of reportable transactions.
- Sec. 208. Modifications to penalty for failure to register tax shelters.
- Sec. 209. Modification of penalty for failure to maintain lists of investors.
- Sec. 210. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.
- Sec. 211. Understatement of taxpayer's liability by income tax return preparer.
- Sec. 212. Penalty on failure to report interests in foreign financial accounts.
- Sec. 213. Frivolous tax submissions.
- Sec. 214. Penalty on promoters of tax shelters.
- Sec. 215. Statute of limitations for taxable years for which listed transactions not reported.
- Sec. 216. Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions.

Subtitle B—Enron-Related Tax Shelter Provisions

- Sec. 221. Limitation on transfer or importation of built-in losses.
- Sec. 222. No reduction of basis under section 734 in stock held by partnership in corporate partner.
- Sec. 223. Repeal of special rules for FASITs.
- Sec. 224. Expanded disallowance of deduction for interest on convertible debt.
- Sec. 225. Expanded authority to disallow tax benefits under section 269.
- Sec. 226. Modifications of certain rules relating to controlled foreign corporations.

Sec. 227. Controlled entities ineligible for REIT status.

Subtitle C—Other Corporate Governance Provisions

PART I—GENERAL PROVISIONS

Sec. 231. Denial of deduction for certain fines, penalties, and other amounts.

Sec. 232. Disallowance of deduction for punitive damages.

PART II—EXECUTIVE COMPENSATION REFORM

Sec. 235. Treatment of nonqualified deferred compensation funded with assets located outside the United States.

Sec. 236. Inclusion in gross income of funded deferred compensation of corporate insiders.

Sec. 237. Prohibition on deferral of gain from the exercise of stock options and restricted stock gains through deferred compensation arrangements.

Sec. 238. Increase in withholding from supplemental wage payments in excess of \$1,000,000.

Subtitle D—International Provisions

PART I—PROVISIONS TO DISCOURAGE EXPATRIATION

Sec. 241. Revision of tax rules on expatriation.

Sec. 242. Tax treatment of inverted corporate entities.

Sec. 243. Excise tax on stock compensation of insiders in inverted corporations.

PART II—OTHER PROVISIONS

Sec. 245. Effectively connected income to include certain foreign source income.

Sec. 246. Determination of basis of amounts paid from foreign pension plans.

Sec. 247. Prevention of mismatching of interest and original issue discount deductions and income inclusions in transactions with related foreign persons.

Subtitle E—Other Revenue Provisions

Sec. 251. Disallowance of certain partnership loss transfers.

Sec. 252. Clarification of exemption from tax for small property and casualty insurance companies.

1 TITLE I—SALES TAX DEDUCTION

2 SEC. 101. DEDUCTION OF STATE AND LOCAL GENERAL

3 SALES TAXES IN LIEU OF STATE AND LOCAL

4 INCOME TAXES.

5 (a) IN GENERAL.—Subsection (b) of section 164 (re-

6 lating to definitions and special rules) is amended by add-

7 ing at the end the following:

1 “(5) GENERAL SALES TAXES.—For purposes of
2 subsection (a)—

3 “(A) ELECTION TO DEDUCT STATE AND
4 LOCAL SALES TAXES IN LIEU OF STATE AND
5 LOCAL INCOME TAXES.—

6 “(i) IN GENERAL.—At the election of
7 the taxpayer for the taxable year, sub-
8 section (a) shall be applied—

9 “(I) without regard to the ref-
10 erence to State and local income
11 taxes,

12 “(II) as if State and local general
13 sales taxes were referred to in a para-
14 graph thereof, and

15 “(III) without regard to the last
16 sentence.

17 “(B) DEFINITION OF GENERAL SALES
18 TAX.—The term ‘general sales tax’ means a tax
19 imposed at one rate with respect to the sale at
20 retail of a broad range of classes of items.

21 “(C) SPECIAL RULES FOR FOOD, ETC.—In
22 the case of items of food, clothing, medical sup-
23 plies, and motor vehicles—

24 “(i) the fact that the tax does not
25 apply with respect to some or all of such

1 items shall not be taken into account in
2 determining whether the tax applies with
3 respect to a broad range of classes of
4 items, and

5 “(ii) the fact that the rate of tax ap-
6 plicable with respect to some or all of such
7 items is lower than the general rate of tax
8 shall not be taken into account in deter-
9 mining whether the tax is imposed at one
10 rate.

11 “(D) ITEMS TAXED AT DIFFERENT
12 RATES.—Except in the case of a lower rate of
13 tax applicable with respect to an item described
14 in subparagraph (C), no deduction shall be al-
15 lowed under this paragraph for any general
16 sales tax imposed with respect to an item at a
17 rate other than the general rate of tax.

18 “(E) COMPENSATING USE TAXES.—A com-
19 pensating use tax with respect to an item shall
20 be treated as a general sales tax. For purposes
21 of the preceding sentence, the term ‘compen-
22 sating use tax’ means, with respect to any item,
23 a tax which—

24 “(i) is imposed on the use, storage, or
25 consumption of such item, and

1 “(ii) is complementary to a general
2 sales tax, but only if a deduction is allow-
3 able under this paragraph with respect to
4 items sold at retail in the taxing jurisdic-
5 tion which are similar to such item.

6 “(F) SPECIAL RULE FOR MOTOR VEHI-
7 CLES.—In the case of motor vehicles, if the rate
8 of tax exceeds the general rate, such excess
9 shall be disregarded and the general rate shall
10 be treated as the rate of tax.

11 “(G) SEPARATELY STATED GENERAL
12 SALES TAXES.—If the amount of any general
13 sales tax is separately stated, then, to the ex-
14 tent that the amount so stated is paid by the
15 consumer (other than in connection with the
16 consumer’s trade or business) to the seller, such
17 amount shall be treated as a tax imposed on,
18 and paid by, such consumer.

19 “(H) AMOUNT OF DEDUCTION TO BE DE-
20 TERMINED UNDER TABLES.—

21 “(i) IN GENERAL.—The amount of
22 the deduction allowed under this para-
23 graph shall be determined under tables
24 prescribed by the Secretary.

1 “(ii) REQUIREMENTS FOR TABLES.—

2 The tables prescribed under clause (i)—

3 “(I) shall reflect the provisions of
4 this paragraph,

5 “(II) shall be based on the aver-
6 age consumption by taxpayers on a
7 State-by-State basis, as determined by
8 the Secretary, taking into account fil-
9 ing status, number of dependents, ad-
10 justed gross income, and rates of
11 State and local general sales taxation,
12 and

13 “(III) need only be determined
14 with respect to adjusted gross incomes
15 up to the applicable amount (as deter-
16 mined under section 68(b)).”.

17 (b) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to taxable years beginning after
19 December 31, 2002.

1 **TITLE II—REVENUE PROVISIONS**
2 **Subtitle A—Provisions Designed To**
3 **Curtail Tax Shelters**

4 **SEC. 201. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
5 **TRINE.**

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

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

11 “(1) GENERAL RULES.—

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

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

18 “(i) IN GENERAL.—A transaction has
19 economic substance only if—

20 “(I) the transaction changes in a
21 meaningful way (apart from Federal
22 tax effects) the taxpayer’s economic
23 position, and

24 “(II) the taxpayer has a substan-
25 tial nontax purpose for entering into

1 such transaction and the transaction
2 is a reasonable means of accom-
3 plishing such purpose.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3 “(C) EXCEPTION FOR PERSONAL TRANS-
4 ACTIONS OF INDIVIDUALS.—In the case of an
5 individual, this subsection shall apply only to
6 transactions entered into in connection with a
7 trade or business or an activity engaged in for
8 the production of income.

9 “(D) TREATMENT OF LESSORS.—A lessor
10 of tangible property subject to a lease shall be
11 treated as satisfying the requirements of para-
12 graph (1)(B)(ii) with respect to the leased prop-
13 erty if such lease satisfies such requirements as
14 provided by the Secretary.

15 “(4) OTHER COMMON LAW DOCTRINES NOT AF-
16 FECTED.—Except as specifically provided in this
17 subsection, the provisions of this subsection shall not
18 be construed as altering or supplanting any other
19 rule of law, and the requirements of this subsection
20 shall be construed as being in addition to any such
21 other rule of law.

22 “(5) REGULATIONS.—The Secretary shall pre-
23 scribe such regulations as may be necessary or ap-
24 propriate to carry out the purposes of this sub-

1 section. Such regulations may include exemptions
2 from the application of this subsection.”.

3 (b) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to transactions entered into on or
5 after May 8, 2003.

6 **SEC. 202. PENALTY FOR FAILING TO DISCLOSE REPORT-**
7 **ABLE TRANSACTION.**

8 (a) IN GENERAL.—Part I of subchapter B of chapter
9 68 (relating to assessable penalties) is amended by insert-
10 ing after section 6707 the following new section:

11 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**
12 **ABLE TRANSACTION INFORMATION WITH RE-**
13 **TURN OR STATEMENT.**

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

20 “(b) AMOUNT OF PENALTY.—

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

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

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

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

8 “(i) a large entity, or

9 “(ii) a high net worth individual,

10 the penalty under paragraph (1) or (2) shall be
11 twice the amount determined without regard to
12 this paragraph.

13 “(B) LARGE ENTITY.—For purposes of
14 subparagraph (A), the term ‘large entity’
15 means, with respect to any taxable year, a per-
16 son (other than a natural person) with gross re-
17 cepts in excess of \$10,000,000 for the taxable
18 year in which the reportable transaction occurs
19 or the preceding taxable year. Rules similar to
20 the rules of paragraph (2) and subparagraphs
21 (B), (C), and (D) of paragraph (3) of section
22 448(c) shall apply for purposes of this subpara-
23 graph.

24 “(C) HIGH NET WORTH INDIVIDUAL.—For
25 purposes of subparagraph (A), the term ‘high

1 net worth individual' means, with respect to a
2 reportable transaction, a natural person whose
3 net worth exceeds \$2,000,000 immediately be-
4 fore the transaction.

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

6 “(1) REPORTABLE TRANSACTION.—The term
7 ‘reportable transaction’ means any transaction with
8 respect to which information is required to be in-
9 cluded with a return or statement because, as deter-
10 mined under regulations prescribed under section
11 6011, such transaction is of a type which the Sec-
12 retary determines as having a potential for tax
13 avoidance or evasion.

14 “(2) LISTED TRANSACTION.—Except as pro-
15 vided in regulations, the term ‘listed transaction’
16 means a reportable transaction which is the same as,
17 or substantially similar to, a transaction specifically
18 identified by the Secretary as a tax avoidance trans-
19 action for purposes of section 6011.

20 “(d) AUTHORITY TO RESCIND PENALTY.—

21 “(1) IN GENERAL.—The Commissioner of In-
22 ternal Revenue may rescind all or any portion of any
23 penalty imposed by this section with respect to any
24 violation if—

1 “(A) the violation is with respect to a re-
2 portable transaction other than a listed trans-
3 action,

4 “(B) the person on whom the penalty is
5 imposed has a history of complying with the re-
6 quirements of this title,

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

9 “(D) imposing the penalty would be
10 against equity and good conscience, and

11 “(E) rescinding the penalty would promote
12 compliance with the requirements of this title
13 and effective tax administration.

14 “(2) DISCRETION.—The exercise of authority
15 under paragraph (1) shall be at the sole discretion
16 of the Commissioner and may be delegated only to
17 the head of the Office of Tax Shelter Analysis. The
18 Commissioner, in the Commissioner’s sole discretion,
19 may establish a procedure to determine if a penalty
20 should be referred to the Commissioner or the head
21 of such Office for a determination under paragraph
22 (1).

23 “(3) NO APPEAL.—Notwithstanding any other
24 provision of law, any determination under this sub-

1 section may not be reviewed in any administrative or
2 judicial proceeding.

3 “(4) RECORDS.—If a penalty is rescinded under
4 paragraph (1), the Commissioner shall place in the
5 file in the Office of the Commissioner the opinion of
6 the Commissioner or the head of the Office of Tax
7 Shelter Analysis with respect to the determination,
8 including—

9 “(A) the facts and circumstances of the
10 transaction,

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

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

13 “(5) REPORT.—The Commissioner shall each
14 year report to the Committee on Ways and Means
15 of the House of Representatives and the Committee
16 on Finance of the Senate—

17 “(A) a summary of the total number and
18 aggregate amount of penalties imposed, and re-
19 scinded, under this section, and

20 “(B) a description of each penalty re-
21 scinded under this subsection and the reasons
22 therefor.

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

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

6 “(2) which—

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

9 “(B) is required to pay a penalty under
10 section 6662A with respect to any reportable
11 transaction at a rate prescribed under section
12 6662A(c), or

13 “(C) is required to pay a penalty under
14 section 6662B with respect to any noneconomic
15 substance transaction,

16 the requirement to pay such penalty shall be disclosed in
17 such reports filed by such person for such periods as the
18 Secretary shall specify. Failure to make a disclosure in
19 accordance with the preceding sentence shall be treated
20 as a failure to which the penalty under subsection (b)(2)
21 applies.

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

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

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

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

9 **SEC. 203. ACCURACY-RELATED PENALTY FOR LISTED**
 10 **TRANSACTIONS AND OTHER REPORTABLE**
 11 **TRANSACTIONS HAVING A SIGNIFICANT TAX**
 12 **AVOIDANCE PURPOSE.**

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

16 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
 17 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
 18 **TO REPORTABLE TRANSACTIONS.**

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

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

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

3 “(A) the product of—

4 “(i) the amount of the increase (if
5 any) in taxable income which results from
6 a difference between the proper tax treat-
7 ment of an item to which this section ap-
8 plies and the taxpayer’s treatment of such
9 item (as shown on the taxpayer’s return of
10 tax), and

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

14 “(B) the amount of the decrease (if any)
15 in the aggregate amount of credits determined
16 under subtitle A which results from a difference
17 between the taxpayer’s treatment of an item to
18 which this section applies (as shown on the tax-
19 payer’s return of tax) and the proper tax treat-
20 ment of such item.

21 For purposes of subparagraph (A), any reduction of
22 the excess of deductions allowed for the taxable year
23 over gross income for such year, and any reduction
24 in the amount of capital losses which would (without

1 regard to section 1211) be allowed for such year,
2 shall be treated as an increase in taxable income.

3 “(2) ITEMS TO WHICH SECTION APPLIES.—This
4 section shall apply to any item which is attributable
5 to—

6 “(A) any listed transaction, and

7 “(B) any reportable transaction (other
8 than a listed transaction) if a significant pur-
9 pose of such transaction is the avoidance or
10 evasion of Federal income tax.

11 “(c) HIGHER PENALTY FOR NONDISCLOSED LISTED
12 AND OTHER AVOIDANCE TRANSACTIONS.—

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

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

20 “(A) IN GENERAL.—If the 1st letter of
21 proposed deficiency which allows the taxpayer
22 an opportunity for administrative review in the
23 Internal Revenue Service Office of Appeals has
24 been sent with respect to a penalty to which
25 paragraph (1) applies, only the Commissioner

1 of Internal Revenue may compromise all or any
2 portion of such penalty.

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

7 “(d) DEFINITIONS OF REPORTABLE AND LISTED
8 TRANSACTIONS.—For purposes of this section, the terms
9 ‘reportable transaction’ and ‘listed transaction’ have the
10 respective meanings given to such terms by section
11 6707A(e).

12 “(e) SPECIAL RULES.—

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

16 “(A) the amount of such understatement
17 (determined without regard to this paragraph)
18 shall be increased by the aggregate amount of
19 reportable transaction understatements and
20 noneconomic substance transaction understate-
21 ments for purposes of determining whether
22 such understatement is a substantial under-
23 statement under section 6662(d)(1), and

24 “(B) the addition to tax under section
25 6662(a) shall apply only to the excess of the

1 amount of the substantial understatement (if
2 any) after the application of subparagraph (A)
3 over the aggregate amount of reportable trans-
4 action understatements and noneconomic sub-
5 stance transaction understatements.

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

8 “(A) APPLICATION OF FRAUD PENALTY.—
9 References to an underpayment in section 6663
10 shall be treated as including references to a re-
11 portable transaction understatement and a non-
12 economic substance transaction understatement.

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

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

1 Secretary regarding the examination of the return or
2 such other date as is specified by the Secretary.

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

8 “(5) CROSS REFERENCE.—

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

9 (b) DETERMINATION OF OTHER UNDERSTATE-
10 MENTS.—Subparagraph (A) of section 6662(d)(2) is
11 amended by adding at the end the following flush sen-
12 tence:

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

18 (c) REASONABLE CAUSE EXCEPTION.—

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

21 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
22 ABLE TRANSACTION UNDERSTATEMENTS.—

23 “(1) IN GENERAL.—No penalty shall be im-
24 posed under section 6662A with respect to any por-

1 tion of a reportable transaction understatement if it
2 is shown that there was a reasonable cause for such
3 portion and that the taxpayer acted in good faith
4 with respect 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
10 in accordance with the regulations prescribed
11 under 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
19 the requirements of subparagraph (A) if the penalty
20 for such failure was rescinded under section
21 6707A(d).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

17 (d) CONFORMING AMENDMENTS.—

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

21 (2) Paragraph (3) of section 1274(b) is amend-
22 ed—

23 (A) by striking “(as defined in section
24 6662(d)(2)(C)(iii))” in subparagraph (B)(i),
25 and

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

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

5 “(i) a partnership or other entity,

6 “(ii) any investment plan or arrange-
7 ment, or

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

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

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

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

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

21 **“SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY**
22 **ON UNDERPAYMENTS.”.**

23 (B) The table of sections for part II of sub-
24 chapter A of chapter 68 is amended by striking the

1 item relating to section 6662 and inserting the fol-
 2 lowing new items:

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

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

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

6 **SEC. 204. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
 7 **UTABLE TO TRANSACTIONS LACKING ECO-**
 8 **NOMIC SUBSTANCE, ETC.**

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

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

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

20 “(b) REDUCTION OF PENALTY FOR DISCLOSED
 21 TRANSACTIONS.—Subsection (a) shall be applied by sub-
 22 stituting ‘20 percent’ for ‘40 percent’ with respect to the
 23 portion of any noneconomic substance transaction under-

1 statement with respect to which the relevant facts affect-
2 ing the tax treatment of the item are adequately disclosed
3 in the return or a statement attached to the return.

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

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

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

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

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

24 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-
25 ALTY.—

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

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

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

15 “(f) CROSS REFERENCES.—

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

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

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

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

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to transactions entered into on or
3 after May 8, 2003.

4 **SEC. 205. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
5 **MENT PENALTY FOR NONREPORTABLE**
6 **TRANSACTIONS.**

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

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

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

20 “(ii) \$10,000,000.”.

21 (b) REDUCTION FOR UNDERSTATEMENT OF TAX-
22 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED
23 ITEM.—

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

4 “(i) the tax treatment of any item by
5 the taxpayer if the taxpayer had reason-
6 able belief that the tax treatment was more
7 likely than not the proper treatment, or”.

8 (2) CONFORMING AMENDMENT.—Section
9 6662(d) is amended by adding at the end the fol-
10 lowing new paragraph:

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

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

1 **SEC. 206. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
2 **PRIVILEGES RELATING TO TAXPAYER COM-**
3 **MUNICATIONS.**

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

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

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

13 “(A) any person,

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

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

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

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

24 **SEC. 207. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

6 “(1) information identifying and describing the
7 transaction,

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

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

12 Such return shall be filed not later than the date specified
13 by the Secretary.

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

15 “(1) MATERIAL ADVISOR.—

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

18 “(i) who provides any material aid,
19 assistance, or advice with respect to orga-
20 nizing, promoting, selling, implementing,
21 or carrying out any reportable transaction,
22 and

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

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

3 “(i) \$50,000 in the case of a report-
4 able transaction substantially all of the tax
5 benefits from which are provided to nat-
6 ural persons, and

7 “(ii) \$250,000 in any other case.

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

11 “(c) REGULATIONS.—The Secretary may prescribe
12 regulations which provide—

13 “(1) that only 1 person shall be required to
14 meet the requirements of subsection (a) in cases in
15 which 2 or more persons would otherwise be re-
16 quired to meet such requirements,

17 “(2) exemptions from the requirements of this
18 section, and

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

21 (b) CONFORMING AMENDMENTS.—

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

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

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

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

5 “(a) IN GENERAL.—Each material advisor (as de-
6 fined in section 6111) with respect to any reportable
7 transaction (as defined in section 6707A(e)) shall main-
8 tain, in such manner as the Secretary may by regulations
9 prescribe, a list—

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

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

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

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

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

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

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

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

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

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

6 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
7 **WITH RESPECT TO REPORTABLE TRANS-**
8 **ACTIONS.”.**

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

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

12 (c) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to transactions with respect to
14 which material aid, assistance, or advice referred to in sec-
15 tion 6111(b)(1)(A)(i) of the Internal Revenue Code of
16 1986 (as added by this section) is provided after the date
17 of the enactment of this Act.

18 **SEC. 208. MODIFICATIONS TO PENALTY FOR FAILURE TO**
19 **REGISTER TAX SHELTERS.**

20 (a) IN GENERAL.—Section 6707 (relating to failure
21 to furnish information regarding tax shelters) is amended
22 to read as follows:

1 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
2 **ING REPORTABLE TRANSACTIONS.**

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

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

8 “(2) files false or incomplete information with
9 the Secretary with respect to such transaction,
10 such person shall pay a penalty with respect to such return
11 in the amount determined under subsection (b).

12 “(b) AMOUNT OF PENALTY.—

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

16 “(2) LISTED TRANSACTIONS.—The penalty im-
17 posed under subsection (a) with respect to any listed
18 transaction shall be an amount equal to the greater
19 of—

20 “(A) \$200,000, or

21 “(B) 50 percent of the gross income de-
22 rived by such person with respect to aid, assist-
23 ance, or advice which is provided with respect
24 to the listed transaction before the date the re-
25 turn including the transaction is filed under
26 section 6111.

1 Subparagraph (B) shall be applied by substituting
 2 ‘75 percent’ for ‘50 percent’ in the case of an inten-
 3 tional failure or act described in subsection (a).

4 “(c) RESCISSION AUTHORITY.—The provisions of
 5 section 6707A(d) (relating to authority of Commissioner
 6 to rescind penalty) shall apply to any penalty imposed
 7 under this section.

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

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

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

19 **SEC. 209. MODIFICATION OF PENALTY FOR FAILURE TO**
 20 **MAINTAIN LISTS OF INVESTORS.**

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

23 “(a) IMPOSITION OF PENALTY.—

24 “(1) IN GENERAL.—If any person who is re-
 25 quired to maintain a list under section 6112(a) fails

1 to make such list available upon written request to
2 the Secretary in accordance with section
3 6112(b)(1)(A) within 20 business days after the
4 date of the Secretary's request, such person shall
5 pay a penalty of \$10,000 for each day of such fail-
6 ure after such 20th day.

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

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

14 **SEC. 210. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
15 **CONDUCT RELATED TO TAX SHELTERS AND**
16 **REPORTABLE TRANSACTIONS.**

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

22 “(a) AUTHORITY TO SEEK INJUNCTION.—A civil ac-
23 tion in the name of the United States to enjoin any person
24 from further engaging in specified conduct may be com-
25 menced at the request of the Secretary. Any action under

1 this section shall be brought in the district court of the
2 United States for the district in which such person resides,
3 has his principal place of business, or has engaged in spec-
4 ified conduct. The court may exercise its jurisdiction over
5 such action (as provided in section 7402(a)) separate and
6 apart from any other action brought by the United States
7 against such person.

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

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

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

14 the court may enjoin such person from engaging in such
15 conduct or in any other activity subject to penalty under
16 this title.

17 “(c) SPECIFIED CONDUCT.—For purposes of this
18 section, the term ‘specified conduct’ means any action, or
19 failure to take action, subject to penalty under section
20 6700, 6701, 6707, or 6708.”.

21 (b) CONFORMING AMENDMENTS.—

22 (1) The heading for section 7408 is amended to
23 read as follows:

1 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
2 **LATED TO TAX SHELTERS AND REPORTABLE**
3 **TRANSACTIONS.”.**

4 (2) The table of sections for subchapter A of
5 chapter 67 is amended by striking the item relating
6 to section 7408 and inserting the following new
7 item:

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

8 (c) **EFFECTIVE DATE.**—The amendment made by
9 this section shall take effect on the day after the date of
10 the enactment of this Act.

11 **SEC. 211. UNDERSTATEMENT OF TAXPAYER’S LIABILITY BY**
12 **INCOME TAX RETURN PREPARER.**

13 (a) **STANDARDS CONFORMED TO TAXPAYER STAND-**
14 **ARDS.**—Section 6694(a) (relating to understatements due
15 to unrealistic positions) is amended—

16 (1) by striking “realistic possibility of being
17 sustained on its merits” in paragraph (1) and in-
18 serting “reasonable belief that the tax treatment in
19 such position was more likely than not the proper
20 treatment”,

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

1 any civil penalty imposed under subpara-
2 graph (A) shall not exceed \$5,000.

3 “(ii) REASONABLE CAUSE EXCEP-
4 TION.—No penalty shall be imposed under
5 subparagraph (A) with respect to any vio-
6 lation if—

7 “(I) such violation was due to
8 reasonable cause, and

9 “(II) the amount of the trans-
10 action or the balance in the account
11 at the time of the transaction was
12 properly reported.

13 “(C) WILLFUL VIOLATIONS.—In the case
14 of any person willfully violating, or willfully
15 causing any violation of, any provision of sec-
16 tion 5314—

17 “(i) the maximum penalty under sub-
18 paragraph (B)(i) shall be increased to the
19 greater of—

20 “(I) \$25,000, or

21 “(II) the amount (not exceeding
22 \$100,000) determined under subpara-
23 graph (D), and

24 “(ii) subparagraph (B)(ii) shall not
25 apply.

1 “(D) AMOUNT.—The amount determined
2 under this subparagraph is—

3 “(i) in the case of a violation involving
4 a transaction, the amount of the trans-
5 action, or

6 “(ii) in the case of a violation involv-
7 ing a failure to report the existence of an
8 account or any identifying information re-
9 quired to be provided with respect to an
10 account, the balance in the account at the
11 time of the violation.”.

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

15 **SEC. 213. FRIVOLOUS TAX SUBMISSIONS.**

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

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

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

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

23 “(A) does not contain information on
24 which the substantial correctness of the self-as-
25 sessment may be judged, or

1 “(B) contains information that on its face
2 indicates that the self-assessment is substan-
3 tially incorrect; and

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

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

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

10 “(b) CIVIL PENALTY FOR SPECIFIED FRIVOLOUS
11 SUBMISSIONS.—

12 “(1) IMPOSITION OF PENALTY.—Except as pro-
13 vided in paragraph (3), any person who submits a
14 specified frivolous submission shall pay a penalty of
15 \$5,000.

16 “(2) SPECIFIED FRIVOLOUS SUBMISSION.—For
17 purposes of this section—

18 “(A) SPECIFIED FRIVOLOUS SUBMIS-
19 SION.—The term ‘specified frivolous submis-
20 sion’ means a specified submission if any por-
21 tion of such submission—

22 “(i) is based on a position which the
23 Secretary has identified as frivolous under
24 subsection (c), or

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

4 “(B) SPECIFIED SUBMISSION.—The term
5 ‘specified submission’ means—

6 “(i) a request for a hearing under—

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

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

13 “(ii) an application under—

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

17 “(II) section 7122 (relating to
18 compromises), or

19 “(III) section 7811 (relating to
20 taxpayer assistance orders).

21 “(3) OPPORTUNITY TO WITHDRAW SUBMIS-
22 SION.—If the Secretary provides a person with no-
23 tice that a submission is a specified frivolous sub-
24 mission and such person withdraws such submission
25 within 30 days after such notice, the penalty im-

1 posed under paragraph (1) shall not apply with re-
 2 spect to such submission.

3 “(c) LISTING OF FRIVOLOUS POSITIONS.—The Sec-
 4 retary shall prescribe (and periodically revise) a list of po-
 5 sitions which the Secretary has identified as being frivo-
 6 lous for purposes of this subsection. The Secretary shall
 7 not include in such list any position that the Secretary
 8 determines meets the requirement of section
 9 6662(d)(2)(B)(ii)(II).

10 “(d) REDUCTION OF PENALTY.—The Secretary may
 11 reduce the amount of any penalty imposed under this sec-
 12 tion if the Secretary determines that such reduction would
 13 promote compliance with and administration of the Fed-
 14 eral tax laws.

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

18 (b) TREATMENT OF FRIVOLOUS REQUESTS FOR
 19 HEARINGS BEFORE LEVY.—

20 (1) FRIVOLOUS REQUESTS DISREGARDED.—
 21 Section 6330 (relating to notice and opportunity for
 22 hearing before levy) is amended by adding at the
 23 end the following new subsection:

24 “(g) FRIVOLOUS REQUESTS FOR HEARING, ETC.—
 25 Notwithstanding any other provision of this section, if the

1 Secretary determines that any portion of a request for a
2 hearing under this section or section 6320 meets the re-
3 quirement of clause (i) or (ii) of section 6702(b)(2)(A),
4 then the Secretary may treat such portion as if it were
5 never submitted and such portion shall not be subject to
6 any further administrative or judicial review.”.

7 (2) PRECLUSION FROM RAISING FRIVOLOUS
8 ISSUES AT HEARING.—Section 6330(c)(4) is amend-
9 ed—

10 (A) by striking “(A)” and inserting
11 “(A)(i)”;

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

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

15 (D) by inserting after subparagraph (A)(ii)
16 (as so redesignated) the following:

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

19 (3) STATEMENT OF GROUNDS.—Section
20 6330(b)(1) is amended by striking “under sub-
21 section (a)(3)(B)” and inserting “in writing under
22 subsection (a)(3)(B) and states the grounds for the
23 requested hearing”.

1 (c) TREATMENT OF FRIVOLOUS REQUESTS FOR
2 HEARINGS UPON FILING OF NOTICE OF LIEN.—Section
3 6320 is amended—

4 (1) in subsection (b)(1), by striking “under sub-
5 section (a)(3)(B)” and inserting “in writing under
6 subsection (a)(3)(B) and states the grounds for the
7 requested hearing”, and

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

10 (d) TREATMENT OF FRIVOLOUS APPLICATIONS FOR
11 OFFERS-IN-COMPROMISE AND INSTALLMENT AGREE-
12 MENTS.—Section 7122 is amended by adding at the end
13 the following new subsection:

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

23 (e) CLERICAL AMENDMENT.—The table of sections
24 for part I of subchapter B of chapter 68 is amended by

1 striking the item relating to section 6702 and inserting
2 the following new item:

“Sec. 6702. Frivolous tax submissions.”.

3 (f) **EFFECTIVE DATE.**—The amendments made by
4 this section shall apply to submissions made and issues
5 raised after the date on which the Secretary first pre-
6 scribes a list under section 6702(c) of the Internal Rev-
7 enue Code of 1986, as amended by subsection (a).

8 **SEC. 214. PENALTY ON PROMOTERS OF TAX SHELTERS.**

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

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

1 **SEC. 215. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
2 **FOR WHICH LISTED TRANSACTIONS NOT RE-**
3 **PORTED.**

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

7 “(C) **LISTED TRANSACTIONS.**—If a tax-
8 payer fails to include on any return or state-
9 ment for any taxable year any information with
10 respect to a listed transaction (as defined in
11 section 6707A(e)(2)) which is required under
12 section 6011 to be included with such return or
13 statement, the tax for such taxable year may be
14 assessed, or a proceeding in court for collection
15 of such tax may be begun without assessment,
16 at any time within 6 years after the time the
17 return is filed. This subparagraph shall not
18 apply to any taxable year if the time for assess-
19 ment or beginning the proceeding in court has
20 expired before the time a transaction is treated
21 as a listed transaction under section 6011.”.

22 (b) **EFFECTIVE DATE.**—The amendment made by
23 this section shall apply to transactions in taxable years
24 beginning after the date of the enactment of this Act.

1 **SEC. 216. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
2 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
3 **CLOSED REPORTABLE AND NONECONOMIC**
4 **SUBSTANCE TRANSACTIONS.**

5 (a) IN GENERAL.—Section 163 (relating to deduction
6 for interest) is amended by redesignating subsection (m)
7 as subsection (n) and by inserting after subsection (l) the
8 following new subsection:

9 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE
10 TO NONDISCLOSED REPORTABLE TRANSACTIONS AND
11 NONECONOMIC SUBSTANCE TRANSACTIONS.—No deduc-
12 tion shall be allowed under this chapter for any interest
13 paid or accrued under section 6601 on any underpayment
14 of tax which is attributable to—

15 “(1) the portion of any reportable transaction
16 understatement (as defined in section 6662A(b))
17 with respect to which the requirement of section
18 6664(d)(2)(A) is not met, or

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

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

1 **Subtitle B—Enron-Related Tax**
 2 **Shelter Provisions**

3 **SEC. 221. LIMITATION ON TRANSFER OR IMPORTATION OF**
 4 **BUILT-IN LOSSES.**

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

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

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

11 “(A) IN GENERAL.—If in any transaction
 12 described in subsection (a) or (b) there would
 13 (but for this subsection) be an importation of a
 14 net built-in loss, the basis of each property de-
 15 scribed in subparagraph (B) which is acquired
 16 in such transaction shall (notwithstanding sub-
 17 sections (a) and (b)) be its fair market value
 18 immediately after such transaction.

19 “(B) PROPERTY DESCRIBED.—For pur-
 20 poses of subparagraph (A), property is de-
 21 scribed in this subparagraph if—

22 “(i) gain or loss with respect to such
 23 property is not subject to tax under this
 24 subtitle in the hands of the transferor im-
 25 mediately before the transfer, and

1 “(ii) gain or loss with respect to such
2 property is subject to such tax in the
3 hands of the transferee immediately after
4 such transfer.

5 In any case in which the transferor is a part-
6 nership, the preceding sentence shall be applied
7 by treating each partner in such partnership as
8 holding such partner’s proportionate share of
9 the property of such partnership.

10 “(C) IMPORTATION OF NET BUILT-IN
11 LOSS.—For purposes of subparagraph (A),
12 there is an importation of a net built-in loss in
13 a transaction if the transferee’s aggregate ad-
14 justed bases of property described in subpara-
15 graph (B) which is transferred in such trans-
16 action would (but for this paragraph) exceed
17 the fair market value of such property imme-
18 diately after such transaction.”.

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

21 “(A) IN GENERAL.—If—

22 “(i) property is transferred by a
23 transferor in any transaction which is de-
24 scribed in subsection (a) and which is not

1 described in paragraph (1) of this sub-
2 section, and

3 “(ii) the transferee’s aggregate ad-
4 justed bases of such property so trans-
5 ferred would (but for this paragraph) ex-
6 ceed the fair market value of such property
7 immediately after such transaction,

8 then, notwithstanding subsection (a), the trans-
9 feree’s aggregate adjusted bases of the property
10 so transferred shall not exceed the fair market
11 value of such property immediately after such
12 transaction.

13 “(B) ALLOCATION OF BASIS REDUC-
14 TION.—The aggregate reduction in basis by
15 reason of subparagraph (A) shall be allocated
16 among the property so transferred in proportion
17 to their respective built-in losses immediately
18 before the transaction.

19 “(C) EXCEPTION FOR TRANSFERS WITHIN
20 AFFILIATED GROUP.—Subparagraph (A) shall
21 not apply to any transaction if the transferor
22 owns stock in the transferee meeting the re-
23 quirements of section 1504(a)(2). In the case of
24 property to which subparagraph (A) does not
25 apply by reason of the preceding sentence, the

1 transferor's basis in the stock received for such
2 property shall not exceed its fair market value
3 immediately after the transfer.”.

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

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

17 “(A) in any case in which gain or loss is
18 recognized by the liquidating corporation with
19 respect to such property, or

20 “(B) in any case in which the liquidating
21 corporation is a foreign corporation, the cor-
22 porate distributee is a domestic corporation,
23 and the corporate distributee's aggregate ad-
24 justed bases of property described in section
25 362(e)(1)(B) which is distributed in such liq-

1 liquidation would (but for this subparagraph) ex-
2 ceed the fair market value of such property im-
3 mediately after such liquidation.”.

4 (c) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to transactions after February 13,
6 2003.

7 **SEC. 222. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
8 **STOCK HELD BY PARTNERSHIP IN COR-**
9 **PORATE PARTNER.**

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

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

16 “(1) no allocation may be made to stock in a
17 corporation (or any person which is related (within
18 the meaning of section 267(b) or 707(b)(1)) to such
19 corporation) which is a partner in the partnership,
20 and

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

24 Gain shall be recognized to the partnership to the extent
25 that the amount required to be allocated under paragraph

1 (2) to other partnership property exceeds the aggregate
2 adjusted basis of such other property immediately before
3 the allocation required by paragraph (2).”.

4 (b) EFFECTIVE DATE.—The amendment made by
5 this section shall apply to distributions after February 13,
6 2003.

7 **SEC. 223. REPEAL OF SPECIAL RULES FOR FASITS.**

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

11 (b) CONFORMING AMENDMENTS.—

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

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

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

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

1 (5) Paragraph (5) of section 860G(a) is amend-
2 ed by adding “and” at the end of subparagraph (B),
3 by striking “, and” at the end of subparagraph (C)
4 and inserting a period, and by striking subparagraph
5 (D).

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

9 (7) 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 (8) The table of parts for subchapter M of
14 chapter 1 is amended by striking the item relating
15 to part V.

16 (c) EFFECTIVE DATE.—

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

20 (2) EXCEPTION FOR EXISTING FASITS.—

21 (A) IN GENERAL.—Paragraph (1) shall not
22 apply to any FASIT in existence on the date of
23 the enactment of this Act to the extent that
24 regular interests issued by the FASIT before

1 such date continue to remain outstanding in ac-
2 cordance with the original terms of issuance.

3 (B) TRANSFER OF ADDITIONAL ASSETS
4 NOT PERMITTED.—Except as provided in regu-
5 lations prescribed by the Secretary of the
6 Treasury or the Secretary’s delegate, subpara-
7 graph (A) shall cease to apply as of the earliest
8 date after the date of the enactment of this Act
9 that any property is transferred to the FASIT.

10 **SEC. 224. EXPANDED DISALLOWANCE OF DEDUCTION FOR**
11 **INTEREST ON CONVERTIBLE DEBT.**

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

16 (b) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED
17 BY DEALERS IN SECURITIES.—Section 163(l) is amended
18 by redesignating paragraphs (4) and (5) as paragraphs
19 (5) and (6) and by inserting after paragraph (3) the fol-
20 lowing new paragraph:

21 “(4) EXCEPTION FOR CERTAIN INSTRUMENTS
22 ISSUED BY DEALERS IN SECURITIES.—For purposes
23 of this subsection, the term ‘disqualified debt instru-
24 ment’ does not include indebtedness issued by a
25 dealer in securities (or a related party) which is pay-

1 able in, or by reference to, equity (other than equity
2 of the issuer or a related party) held by such dealer
3 in its capacity as a dealer in securities. For purposes
4 of this paragraph, the term ‘dealer in securities’ has
5 the meaning given such term by section 475.”.

6 (c) CONFORMING AMENDMENT.—Paragraph (3) of
7 section 163(l) is amended by striking “or a related party”
8 in the material preceding subparagraph (A) and inserting
9 “or any other person”.

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

13 **SEC. 225. EXPANDED AUTHORITY TO DISALLOW TAX BENE-**
14 **FITS UNDER SECTION 269.**

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

18 “(a) IN GENERAL.—If—

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

21 “(B) any corporation acquires, directly or indi-
22 rectly, property of another corporation and the basis
23 of such property, in the hands of the acquiring cor-
24 poration, is determined by reference to the basis in
25 the hands of the transferor corporation, and

1 “(2) the principal purpose for which such acqui-
2 sition was made is evasion or avoidance of Federal
3 income tax by securing the benefit of a deduction,
4 credit, or other allowance,
5 then the Secretary may disallow such deduction, credit,
6 or other allowance.”.

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

10 **SEC. 226. MODIFICATIONS OF CERTAIN RULES RELATING**
11 **TO CONTROLLED FOREIGN CORPORATIONS.**

12 (a) LIMITATION ON EXCEPTION FROM PFIC RULES
13 FOR UNITED STATES SHAREHOLDERS OF CONTROLLED
14 FOREIGN CORPORATIONS.—Paragraph (2) of section
15 1297(e) (relating to passive investment company) is
16 amended by adding at the end the following flush sen-
17 tence:

18 “Such term shall not include any period if there is
19 only a remote likelihood of an inclusion in gross in-
20 come under section 951(a)(1)(A)(i) of subpart F in-
21 come of such corporation for such period.”.

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

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

3 **SEC. 227. CONTROLLED ENTITIES INELIGIBLE FOR REIT**
4 **STATUS.**

5 (a) IN GENERAL.—Subsection (a) of section 856 (re-
6 lating to definition of real estate investment trust) is
7 amended by striking “and” at the end of paragraph (6),
8 by redesignating paragraph (7) as paragraph (8), and by
9 inserting after paragraph (6) the following new paragraph:

10 “(7) which is not a controlled entity (as defined
11 in subsection (1)); and”.

12 (b) CONTROLLED ENTITY.—Section 856 is amended
13 by adding at the end the following new subsection:

14 “(1) CONTROLLED ENTITY.—

15 “(1) IN GENERAL.—For purposes of subsection
16 (a)(7), an entity is a controlled entity if, at any time
17 during the taxable year, one person (other than a
18 qualified entity)—

19 “(A) in the case of a corporation, owns
20 stock—

21 “(i) possessing at least 50 percent of
22 the total voting power of the stock of such
23 corporation, or

1 “(ii) having a value equal to at least
2 50 percent of the total value of the stock
3 of such corporation, or

4 “(B) in the case of a trust, owns beneficial
5 interests in the trust which would meet the re-
6 quirements of subparagraph (A) if such inter-
7 ests were stock.

8 “(2) QUALIFIED ENTITY.—For purposes of
9 paragraph (1), the term ‘qualified entity’ means—

10 “(A) any real estate investment trust, and

11 “(B) any partnership in which one real es-
12 tate investment trust owns at least 50 percent
13 of the capital and profits interests in the part-
14 nership.

15 “(3) CONTRIBUTION RULES.—For purposes of
16 this paragraphs (1) and (2)—

17 “(A) IN GENERAL.—Rules similar to the
18 rules of subsections (d)(5) and (h)(3) shall
19 apply; except that section 318(a)(3)(C) shall
20 not be applied under such rules to treat stock
21 owned by a qualified entity as being owned by
22 a person which is not a qualified entity.

23 “(B) STAPLED ENTITIES.—A group of en-
24 tities which are stapled entities (as defined in

1 section 269B(c)(2)) shall be treated as one per-
2 son.

3 “(4) EXCEPTION FOR CERTAIN NEW REITS.—

4 “(A) IN GENERAL.—The term ‘controlled
5 entity’ shall not include an incubator REIT.

6 “(B) INCUBATOR REIT.—A corporation
7 shall be treated as an incubator REIT for any
8 taxable year during the eligibility period if it
9 meets all the following requirements for such
10 year:

11 “(i) The corporation elects to be treat-
12 ed as an incubator REIT.

13 “(ii) The corporation has only voting
14 common stock outstanding.

15 “(iii) Not more than 50 percent of the
16 corporation’s real estate assets consist of
17 mortgages.

18 “(iv) From not later than the begin-
19 ning of the last half of the second taxable
20 year, at least 10 percent of the corpora-
21 tion’s capital is provided by lenders or eq-
22 uity investors who are unrelated to the cor-
23 poration’s largest shareholder.

1 “(v) The corporation annually in-
2 creases the value of its real estate assets
3 by at least 10 percent.

4 “(vi) The directors of the corporation
5 adopt a resolution setting forth an intent
6 to engage in a going public transaction.

7 No election may be made with respect to any
8 REIT if an election under this subsection was
9 in effect for any predecessor of such REIT.

10 “(C) ELIGIBILITY PERIOD.—

11 “(i) IN GENERAL.—The eligibility pe-
12 riod (for which an incubator REIT election
13 can be made) begins with the REIT’s sec-
14 ond taxable year and ends at the close of
15 the REIT’s third taxable year, except that
16 the REIT may, subject to clauses (ii), (iii),
17 and (iv), elect to extend such period for an
18 additional 2 taxable years.

19 “(ii) GOING PUBLIC TRANSACTION.—
20 A REIT may not elect to extend the eligi-
21 bility period under clause (i) unless it en-
22 ters into an agreement with the Secretary
23 that if it does not engage in a going public
24 transaction by the end of the extended eli-
25 gibility period, it shall pay Federal income

1 taxes for the 2 years of the extended eligi-
2 bility period as if it had not made an incu-
3 bator REIT election and had ceased to
4 qualify as a REIT for those 2 taxable
5 years.

6 “(iii) RETURNS, INTEREST, AND NO-
7 TICE.—

8 “(I) RETURNS.—In the event the
9 corporation ceases to be treated as a
10 REIT by operation of clause (ii), the
11 corporation shall file any appropriate
12 amended returns reflecting the change
13 in status within 3 months of the close
14 of the extended eligibility period.

15 “(II) INTEREST.—Interest shall
16 be payable on any tax imposed by rea-
17 son of clause (ii) for any taxable year
18 but, unless there was a finding under
19 subparagraph (D), no substantial un-
20 derpayment penalties shall be im-
21 posed.

22 “(III) NOTICE.—The corporation
23 shall, at the same time it files its re-
24 turns under subclause (I), notify its
25 shareholders and any other persons

1 whose tax position is, or may reason-
2 ably be expected to be, affected by the
3 change in status so they also may file
4 any appropriate amended returns to
5 conform their tax treatment consistent
6 with the corporation's loss of REIT
7 status.

8 “(IV) REGULATIONS.—The Sec-
9 retary shall provide appropriate regu-
10 lations setting forth transferee liabil-
11 ity and other provisions to ensure col-
12 lection of tax and the proper adminis-
13 tration of this provision.

14 “(iv) Clauses (ii) and (iii) shall not
15 apply if the corporation allows its incu-
16 bator REIT status to lapse at the end of
17 the initial 2-year eligibility period without
18 engaging in a going public transaction if
19 the corporation is not a controlled entity as
20 of the beginning of its fourth taxable year.
21 In such a case, the corporation's directors
22 may still be liable for the penalties de-
23 scribed in subparagraph (D) during the eli-
24 gibility period.

1 “(D) SPECIAL PENALTIES.—If the Sec-
2 retary determines that an incubator REIT elec-
3 tion was filed for a principal purpose other than
4 as part of a reasonable plan to undertake a
5 going public transaction, an excise tax of
6 \$20,000 shall be imposed on each of the cor-
7 poration’s directors for each taxable year for
8 which an election was in effect.

9 “(E) GOING PUBLIC TRANSACTION.—For
10 purposes of this paragraph, a going public
11 transaction means—

12 “(i) a public offering of shares of the
13 stock of the incubator REIT;

14 “(ii) a transaction, or series of trans-
15 actions, that results in the stock of the in-
16 cubator REIT being regularly traded on an
17 established securities market and that re-
18 sults in at least 50 percent of such stock
19 being held by shareholders who are unre-
20 lated to persons who held such stock before
21 it began to be so regularly traded; or

22 “(iii) any transaction resulting in
23 ownership of the REIT by 200 or more
24 persons (excluding the largest single share-

1 holder) who in the aggregate own at least
2 50 percent of the stock of the REIT.

3 For the purposes of this subparagraph, the
4 rules of paragraph (3) shall apply in deter-
5 mining the ownership of stock.

6 “(F) DEFINITIONS.—The term ‘established
7 securities market’ shall have the meaning set
8 forth in the regulations under section 897.”.

9 (c) CONFORMING AMENDMENT.—Paragraph (2) of
10 section 856(h) is amended by striking “and (6)” each
11 place it appears and inserting “, (6), and (7)”.

12 (d) EFFECTIVE DATE.—

13 (1) IN GENERAL.—The amendments made by
14 this section shall apply to taxable years ending after
15 May 8, 2003.

16 (2) EXCEPTION FOR EXISTING CONTROLLED
17 ENTITIES.—The amendments made by this section
18 shall not apply to any entity which is a controlled
19 entity (as defined in section 856(l) of the Internal
20 Revenue Code of 1986, as added by this section) as
21 of May 8, 2003, which is a real estate investment
22 trust for the taxable year which includes such date,
23 and which has significant business assets or activi-
24 ties as of such date. For purposes of the preceding
25 sentence, an entity shall be treated as such a con-

1 trolled entity on May 8, 2003, if it becomes such an
2 entity after such date in a transaction—

3 (A) made pursuant to a written agreement
4 which was binding on such date and at all times
5 thereafter, or

6 (B) described on or before such date in a
7 filing with the Securities and Exchange Com-
8 mission required solely by reason of the trans-
9 action.

10 **Subtitle C—Other Corporate** 11 **Governance Provisions**

12 **PART I—GENERAL PROVISIONS**

13 **SEC. 231. DENIAL OF DEDUCTION FOR CERTAIN FINES,** 14 **PENALTIES, AND OTHER AMOUNTS.**

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

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

19 “(1) IN GENERAL.—Except as provided in para-
20 graph (2), no deduction otherwise allowable shall be
21 allowed under this chapter for any amount paid or
22 incurred (whether by suit, agreement, or otherwise)
23 to, or at the direction of, a government or entity de-
24 scribed in paragraph (3) in relation to the violation

1 of any law or the investigation or inquiry into the
2 potential violation of any law.

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

12 “(3) CERTAIN NONGOVERNMENTAL REGU-
13 LATORY ENTITIES.—An entity is described in this
14 paragraph if it is—

15 “(A) a nongovernmental entity which exer-
16 cises self-regulatory powers (including imposing
17 sanctions) in connection with a qualified board
18 or exchange (as defined in section 1256(g)(7)),
19 or

20 “(B) to the extent provided in regulations,
21 a nongovernmental entity which exercises self-
22 regulatory powers (including imposing sanc-
23 tions) as part of performing an essential gov-
24 ernmental function.”.

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to amounts paid or incurred after
3 April 27, 2003, except that such amendment shall not
4 apply to amounts paid or incurred under any binding
5 order or agreement entered into on or before April 27,
6 2003. Such exception shall not apply to an order or agree-
7 ment requiring court approval unless the approval was ob-
8 tained on or before April 27, 2003.

9 **SEC. 232. DISALLOWANCE OF DEDUCTION FOR PUNITIVE**
10 **DAMAGES.**

11 (a) DISALLOWANCE OF DEDUCTION.—

12 (1) IN GENERAL.—Section 162(g) (relating to
13 treble damage payments under the antitrust laws) is
14 amended by adding at the end the following new
15 paragraph:

16 “(2) PUNITIVE DAMAGES.—No deduction shall
17 be allowed under this chapter for any amount paid
18 or incurred for punitive damages in connection with
19 any judgment in, or settlement of, any action. This
20 paragraph shall not apply to punitive damages de-
21 scribed in section 104(c).”.

22 (2) CONFORMING AMENDMENTS.—

23 (A) Section 162(g) is amended—

24 (i) by striking “If” and inserting:

25 “(1) TREBLE DAMAGES.—If”, and

1 (ii) by redesignating paragraphs (1)
2 and (2) as subparagraphs (A) and (B), re-
3 spectively.

4 (B) The heading for section 162(g) is
5 amended by inserting “OR PUNITIVE DAM-
6 AGES” after “LAWS”.

7 (b) INCLUSION IN INCOME OF PUNITIVE DAMAGES
8 PAID BY INSURER OR OTHERWISE.—

9 (1) IN GENERAL.—Part II of subchapter B of
10 chapter 1 (relating to items specifically included in
11 gross income) is amended by adding at the end the
12 following new section:

13 **“SEC. 91. PUNITIVE DAMAGES COMPENSATED BY INSUR-**
14 **ANCE OR OTHERWISE.**

15 “Gross income shall include any amount paid to or
16 on behalf of a taxpayer as insurance or otherwise by rea-
17 son of the taxpayer’s liability (or agreement) to pay puni-
18 tive damages.”.

19 (2) REPORTING REQUIREMENTS.—Section 6041
20 (relating to information at source) is amended by
21 adding at the end the following new subsection:

22 “(f) SECTION TO APPLY TO PUNITIVE DAMAGES
23 COMPENSATION.—This section shall apply to payments by
24 a person to or on behalf of another person as insurance

1 or otherwise by reason of the other person’s liability (or
2 agreement) to pay punitive damages.”.

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

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

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

10 **PART II—EXECUTIVE COMPENSATION REFORM**

11 **SEC. 235. TREATMENT OF NONQUALIFIED DEFERRED COM-**
12 **PENSATION FUNDED WITH ASSETS LOCATED**
13 **OUTSIDE THE UNITED STATES.**

14 (a) IN GENERAL.—Section 83(c) (relating to special
15 rules for property transferred in connection with perform-
16 ance of services) is amended by adding at the end the fol-
17 lowing new paragraph:

18 “(4) FOREIGN ASSETS FUNDING NONQUALIFIED
19 DEFERRED COMPENSATION ARRANGEMENTS.—

20 “(A) IN GENERAL.—In determining wheth-
21 er there is a transfer of property for purposes
22 of subsection (a), if assets are—

23 “(i) designated or otherwise available
24 for the payment of nonqualified deferred
25 compensation, and

1 “(ii) located outside the United
2 States,
3 such assets shall not be treated as subject to
4 the claims of creditors.

5 “(B) COMPENSATION FOR SERVICES PER-
6 FORMED IN FOREIGN JURISDICTION.—Subpara-
7 graph (A) shall not apply to assets located in
8 a foreign jurisdiction if substantially all of the
9 services to which the nonqualified deferred com-
10 pensation relates are performed in such juris-
11 diction.

12 “(C) REGULATIONS.—The Secretary shall
13 prescribe such regulations as are necessary to
14 carry out the provisions of this paragraph, in-
15 cluding regulations to exempt arrangements
16 from the application of this paragraph if—

17 “(i) the arrangement will not result in
18 an improper deferral of United States tax,
19 and

20 “(ii) the assets involved in the ar-
21 rangement will be readily accessible in any
22 insolvency or bankruptcy proceeding.”.

23 (b) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to amounts deferred in taxable
25 years beginning after December 31, 2003.

1 **SEC. 236. INCLUSION IN GROSS INCOME OF FUNDED DE-**
 2 **FERRED COMPENSATION OF CORPORATE IN-**
 3 **SIDERS.**

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

7 **“SEC. 409A. INCLUSION IN GROSS INCOME OF FUNDED DE-**
 8 **FERRED COMPENSATION OF CORPORATE IN-**
 9 **SIDERS.**

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

12 “(1) compensation of any disqualified individual
 13 which is deferred under such funded deferred com-
 14 pensation plan shall be included in the gross income
 15 of the disqualified individual or beneficiary for the
 16 1st taxable year in which there is no substantial risk
 17 of forfeiture of the rights to such compensation, and

18 “(2) the tax treatment of any amount made
 19 available under the plan to a disqualified individual
 20 or beneficiary shall be determined under section 72
 21 (relating to annuities, etc.).

22 “(b) FUNDED DEFERRED COMPENSATION PLAN.—
 23 For purposes of this section—

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

1 “(A) the employee’s rights to the com-
2 pensation deferred under the plan are no great-
3 er than the rights of a general creditor of the
4 employer, and

5 “(B) all amounts set aside (directly or in-
6 directly) for purposes of paying the deferred
7 compensation, and all income attributable to
8 such amounts, remain (until made available to
9 the participant or other beneficiary) solely the
10 property of the employer (without being re-
11 stricted to the provision of benefits under the
12 plan),

13 “(C) the amounts referred to in subpara-
14 graph (B) are available to satisfy the claims of
15 the employer’s general creditors at all times
16 (not merely after bankruptcy or insolvency),
17 and

18 “(D) the investment options which a par-
19 ticipant may elect under the plan are the same
20 as the investment options which a participant
21 may elect under the qualified employer plan of
22 the employer which has the fewest investment
23 options.

24 Such term shall not include a qualified employer
25 plan.

1 “(2) SPECIAL RULES.—

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

5 “(i) the compensation deferred under
6 the plan is payable only upon separation
7 from service, death, disability (within the
8 meaning of section 1614(a)(3) of the So-
9 cial Security Act (42 U.S.C. 1382c(a)(3))),
10 or at a specified time (or pursuant to a
11 fixed schedule), and

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

16 If the employer and employee agree to a modi-
17 fication of the plan that accelerates the time for
18 payment of any deferred compensation, then all
19 compensation previously deferred under the
20 plan shall be includible in gross income for the
21 taxable year during which such modification
22 takes effect and the taxpayer shall pay interest
23 at the underpayment rate on the underpay-
24 ments that would have occurred had the de-
25 ferred compensation been includible in gross in-

1 come on the earliest date that there is no sub-
2 stantial risk of forfeiture of the rights to such
3 compensation.

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

8 “(i) the employee has no beneficial in-
9 terest in the trust,

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

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

20 Except as provided in regulations prescribed by
21 the Secretary, such a factor shall include the lo-
22 cation of the trust outside the United States
23 unless substantially all of the services to which
24 the nonqualified deferred compensation relates
25 are performed outside the United States. Such

1 regulations may exempt any such trust if the
2 trust will not result in an improper deferral of
3 United States tax, and the assets involved in
4 the trust will be readily accessible in any insol-
5 vency or bankruptcy proceeding.

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

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

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

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

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

19 “(A) any plan, contract, pension, account,
20 or trust described in subparagraph (A) or (B)
21 of section 219(g)(5), and

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

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

4 “(3) SUBSTANTIAL RISK OF FORFEITURE.—The
5 rights of a person to compensation are subject to a
6 substantial risk of forfeiture if such person’s rights
7 to such compensation are conditioned upon the fu-
8 ture performance of substantial services by any indi-
9 vidual.

10 “(4) TREATMENT OF EARNINGS.—References to
11 deferred compensation shall be treated as including
12 references to income attributable to such compensa-
13 tion or such income.”.

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

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

17 (c) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to amounts deferred in taxable
19 years beginning after December 31, 2003.

1 **SEC. 237. PROHIBITION ON DEFERRAL OF GAIN FROM THE**
2 **EXERCISE OF STOCK OPTIONS AND RE-**
3 **STRICTED STOCK GAINS THROUGH DE-**
4 **FERRED COMPENSATION ARRANGEMENTS.**

5 (a) IN GENERAL.—Section 83 (relating to property
6 transferred in connection with performance of services) is
7 amending by adding at the end the following new sub-
8 section:

9 “(i) PROHIBITION ON ADDITIONAL DEFERRAL
10 THROUGH DEFERRED COMPENSATION ARRANGE-
11 MENTS.—If a taxpayer elects to exchange an option to
12 purchase employer securities—

13 “(1) to which subsection (a) applies, or
14 “(2) which is described in subsection (e)(3),
15 or any other compensation based on employer securities,
16 for a right to receive future payments, then, notwith-
17 standing any other provision of this title, there shall be
18 included in gross income for the taxable year of the ex-
19 change an amount equal to the present value of such right
20 (or such other amount as the Secretary may by regulations
21 specify). For purposes of this subsection, the term ‘em-
22 ployer securities’ has the meaning given such term by sec-
23 tion 409(l).”.

24 (b) EFFECTIVE DATE.—The amendment made by
25 this section shall apply to any exchange after December
26 31, 2003.

1 **SEC. 238. INCREASE IN WITHHOLDING FROM SUPPLE-**
2 **MENTAL WAGE PAYMENTS IN EXCESS OF**
3 **\$1,000,000.**

4 (a) IN GENERAL.—If an employer elects under
5 Treasury Regulation 31.3402(g)–1 to determine the
6 amount to be deducted and withheld from any supple-
7 mental wage payment by using a flat percentage rate, the
8 rate to be used in determining the amount to be so de-
9 ducted and withheld shall not be less than 28 percent (or
10 the corresponding rate in effect under section 1(i)(2) of
11 the Internal Revenue Code of 1986 for taxable years be-
12 ginning in the calendar year in which the payment is
13 made).

14 (b) SPECIAL RULE FOR LARGE PAYMENTS.—

15 (1) IN GENERAL.—Notwithstanding subsection
16 (a), if the supplemental wage payment, when added
17 to all such payments previously made by the em-
18 ployer to the employee during the calendar year, ex-
19 ceeds \$1,000,000, the rate used with respect to such
20 excess shall be equal to the maximum rate of tax in
21 effect under section 1 of such Code for taxable years
22 beginning in such calendar year.

23 (2) AGGREGATION.—All persons treated as a
24 single employer under subsection (a) or (b) of sec-
25 tion 52 of the Internal Revenue Code of 1986 shall

1 be treated as a single employer for purposes of this
2 subsection.

3 (c) CONFORMING AMENDMENT.—Section 13273 of
4 the Revenue Reconciliation Act of 1993 (Public Law 103–
5 66) is repealed.

6 (d) EFFECTIVE DATE.—The provisions of, and the
7 amendment made by, this section shall apply to payments
8 made after December 31, 2003.

9 **Subtitle D—International** 10 **Provisions**

11 **PART I—PROVISIONS TO DISCOURAGE**

12 **EXPATRIATION**

13 **SEC. 241. REVISION OF TAX RULES ON EXPATRIATION.**

14 (a) IN GENERAL.—Subpart A of part II of sub-
15 chapter N of chapter 1 is amended by inserting after sec-
16 tion 877 the following new section:

17 **“SEC. 877A. TAX RESPONSIBILITIES OF EXPATRIATION.**

18 “(a) GENERAL RULES.—For purposes of this sub-
19 title—

20 “(1) MARK TO MARKET.—Except as provided in
21 subsections (d) and (f), all property of a covered ex-
22 patriate to whom this section applies shall be treated
23 as sold on the day before the expatriation date for
24 its fair market value.

1 “(2) RECOGNITION OF GAIN OR LOSS.—In the
2 case of any sale under paragraph (1)—

3 “(A) notwithstanding any other provision
4 of this title, any gain arising from such sale
5 shall be taken into account for the taxable year
6 of the sale, and

7 “(B) any loss arising from such sale shall
8 be taken into account for the taxable year of
9 the sale to the extent otherwise provided by this
10 title, except that section 1091 shall not apply to
11 any such loss.

12 Proper adjustment shall be made in the amount of
13 any gain or loss subsequently realized for gain or
14 loss taken into account under the preceding sen-
15 tence.

16 “(3) EXCLUSION FOR CERTAIN GAIN.—

17 “(A) IN GENERAL.—The amount which,
18 but for this paragraph, would be includible in
19 the gross income of any individual by reason of
20 this section shall be reduced (but not below
21 zero) by \$600,000. For purposes of this para-
22 graph, allocable expatriation gain taken into ac-
23 count under subsection (f)(2) shall be treated in
24 the same manner as an amount required to be
25 includible in gross income.

1 “(B) COST-OF-LIVING ADJUSTMENT.—

2 “(i) IN GENERAL.—In the case of an
3 expatriation date occurring in any calendar
4 year after 2003, the \$600,000 amount
5 under subparagraph (A) shall be increased
6 by an amount equal to—

7 “(I) such dollar amount, multi-
8 plied by

9 “(II) the cost-of-living adjust-
10 ment determined under section 1(f)(3)
11 for such calendar year, determined by
12 substituting ‘calendar year 2002’ for
13 ‘calendar year 1992’ in subparagraph
14 (B) thereof.

15 “(ii) ROUNDING RULES.—If any
16 amount after adjustment under clause (i)
17 is not a multiple of \$1,000, such amount
18 shall be rounded to the next lower multiple
19 of \$1,000.

20 “(4) ELECTION TO CONTINUE TO BE TAXED AS
21 UNITED STATES CITIZEN.—

22 “(A) IN GENERAL.—If a covered expatriate
23 elects the application of this paragraph—

1 “(i) this section (other than this para-
2 graph and subsection (i)) shall not apply to
3 the expatriate, but

4 “(ii) in the case of property to which
5 this section would apply but for such elec-
6 tion, the expatriate shall be subject to tax
7 under this title in the same manner as if
8 the individual were a United States citizen.

9 “(B) REQUIREMENTS.—Subparagraph (A)
10 shall not apply to an individual unless the indi-
11 vidual—

12 “(i) provides security for payment of
13 tax in such form and manner, and in such
14 amount, as the Secretary may require,

15 “(ii) consents to the waiver of any
16 right of the individual under any treaty of
17 the United States which would preclude as-
18 sessment or collection of any tax which
19 may be imposed by reason of this para-
20 graph, and

21 “(iii) complies with such other re-
22 quirements as the Secretary may prescribe.

23 “(C) ELECTION.—An election under sub-
24 paragraph (A) shall apply to all property to
25 which this section would apply but for the elec-

1 tion and, once made, shall be irrevocable. Such
2 election shall also apply to property the basis of
3 which is determined in whole or in part by ref-
4 erence to the property with respect to which the
5 election was made.

6 “(b) ELECTION TO DEFER TAX.—

7 “(1) IN GENERAL.—If the taxpayer elects the
8 application of this subsection with respect to any
9 property treated as sold by reason of subsection (a),
10 the payment of the additional tax attributable to
11 such property shall be postponed until the due date
12 of the return for the taxable year in which such
13 property is disposed of (or, in the case of property
14 disposed of in a transaction in which gain is not rec-
15 ognized in whole or in part, until such other date as
16 the Secretary may prescribe).

17 “(2) DETERMINATION OF TAX WITH RESPECT
18 TO PROPERTY.—For purposes of paragraph (1), the
19 additional tax attributable to any property is an
20 amount which bears the same ratio to the additional
21 tax imposed by this chapter for the taxable year
22 solely by reason of subsection (a) as the gain taken
23 into account under subsection (a) with respect to
24 such property bears to the total gain taken into ac-

1 count under subsection (a) with respect to all prop-
2 erty to which subsection (a) applies.

3 “(3) TERMINATION OF POSTPONEMENT.—No
4 tax may be postponed under this subsection later
5 than the due date for the return of tax imposed by
6 this chapter for the taxable year which includes the
7 date of death of the expatriate (or, if earlier, the
8 time that the security provided with respect to the
9 property fails to meet the requirements of paragraph
10 (4), unless the taxpayer corrects such failure within
11 the time specified by the Secretary).

12 “(4) SECURITY.—

13 “(A) IN GENERAL.—No election may be
14 made under paragraph (1) with respect to any
15 property unless adequate security is provided to
16 the Secretary with respect to such property.

17 “(B) ADEQUATE SECURITY.—For purposes
18 of subparagraph (A), security with respect to
19 any property shall be treated as adequate secu-
20 rity if—

21 “(i) it is a bond in an amount equal
22 to the deferred tax amount under para-
23 graph (2) for the property, or

1 “(ii) the taxpayer otherwise estab-
2 lishes to the satisfaction of the Secretary
3 that the security is adequate.

4 “(5) WAIVER OF CERTAIN RIGHTS.—No elec-
5 tion may be made under paragraph (1) unless the
6 taxpayer consents to the waiver of any right under
7 any treaty of the United States which would pre-
8 clude assessment or collection of any tax imposed by
9 reason of this section.

10 “(6) ELECTIONS.—An election under paragraph
11 (1) shall only apply to property described in the elec-
12 tion and, once made, is irrevocable. An election may
13 be made under paragraph (1) with respect to an in-
14 terest in a trust with respect to which gain is re-
15 quired to be recognized under subsection (f)(1).

16 “(7) INTEREST.—For purposes of section
17 6601—

18 “(A) the last date for the payment of tax
19 shall be determined without regard to the elec-
20 tion under this subsection, and

21 “(B) section 6621(a)(2) shall be applied by
22 substituting ‘5 percentage points’ for ‘3 per-
23 centage points’ in subparagraph (B) thereof.

24 “(c) COVERED EXPATRIATE.—For purposes of this
25 section—

1 “(1) IN GENERAL.—Except as provided in para-
2 graph (2), the term ‘covered expatriate’ means an
3 expatriate.

4 “(2) EXCEPTIONS.—An individual shall not be
5 treated as a covered expatriate if—

6 “(A) the individual—

7 “(i) became at birth a citizen of the
8 United States and a citizen of another
9 country and, as of the expatriation date,
10 continues to be a citizen of, and is taxed
11 as a resident of, such other country, and

12 “(ii) has not been a resident of the
13 United States (as defined in section
14 7701(b)(1)(A)(ii)) during the 5 taxable
15 years ending with the taxable year during
16 which the expatriation date occurs, or

17 “(B)(i) the individual’s relinquishment of
18 United States citizenship occurs before such in-
19 dividual attains age 18½, and

20 “(ii) the individual has been a resident of
21 the United States (as so defined) for not more
22 than 5 taxable years before the date of relin-
23 quishment.

24 “(d) EXEMPT PROPERTY; SPECIAL RULES FOR PEN-
25 SION PLANS.—

1 “(1) EXEMPT PROPERTY.—This section shall
2 not apply to the following:

3 “(A) UNITED STATES REAL PROPERTY IN-
4 TERESTS.—Any United States real property in-
5 terest (as defined in section 897(c)(1)), other
6 than stock of a United States real property
7 holding corporation which does not, on the day
8 before the expatriation date, meet the require-
9 ments of section 897(c)(2).

10 “(B) SPECIFIED PROPERTY.—Any prop-
11 erty or interest in property not described in
12 subparagraph (A) which the Secretary specifies
13 in regulations.

14 “(2) SPECIAL RULES FOR CERTAIN RETIRE-
15 MENT PLANS.—

16 “(A) IN GENERAL.—If a covered expatriate
17 holds on the day before the expatriation date
18 any interest in a retirement plan to which this
19 paragraph applies—

20 “(i) such interest shall not be treated
21 as sold for purposes of subsection (a)(1),
22 but

23 “(ii) an amount equal to the present
24 value of the expatriate’s nonforfeitable ac-
25 crued benefit shall be treated as having

1 been received by such individual on such
2 date as a distribution under the plan.

3 “(B) TREATMENT OF SUBSEQUENT DIS-
4 TRIBUTIONS.—In the case of any distribution
5 on or after the expatriation date to or on behalf
6 of the covered expatriate from a plan from
7 which the expatriate was treated as receiving a
8 distribution under subparagraph (A), the
9 amount otherwise includible in gross income by
10 reason of the subsequent distribution shall be
11 reduced by the excess of the amount includible
12 in gross income under subparagraph (A) over
13 any portion of such amount to which this sub-
14 paragraph previously applied.

15 “(C) TREATMENT OF SUBSEQUENT DIS-
16 TRIBUTIONS BY PLAN.—For purposes of this
17 title, a retirement plan to which this paragraph
18 applies, and any person acting on the plan’s be-
19 half, shall treat any subsequent distribution de-
20 scribed in subparagraph (B) in the same man-
21 ner as such distribution would be treated with-
22 out regard to this paragraph.

23 “(D) APPLICABLE PLANS.—This para-
24 graph shall apply to—

1 “(i) any qualified retirement plan (as
2 defined in section 4974(c)),

3 “(ii) an eligible deferred compensation
4 plan (as defined in section 457(b)) of an
5 eligible employer described in section
6 457(e)(1)(A), and

7 “(iii) to the extent provided in regula-
8 tions, any foreign pension plan or similar
9 retirement arrangements or programs.

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

11 “(1) EXPATRIATE.—The term ‘expatriate’
12 means—

13 “(A) any United States citizen who relin-
14 quishes citizenship, and

15 “(B) any long-term resident of the United
16 States who—

17 “(i) ceases to be a lawful permanent
18 resident of the United States (within the
19 meaning of section 7701(b)(6)), or

20 “(ii) commences to be treated as a
21 resident of a foreign country under the
22 provisions of a tax treaty between the
23 United States and the foreign country and
24 who does not waive the benefits of such

1 treaty applicable to residents of the foreign
2 country.

3 “(2) EXPATRIATION DATE.—The term ‘expa-
4 triation date’ means—

5 “(A) the date an individual relinquishes
6 United States citizenship, or

7 “(B) in the case of a long-term resident of
8 the United States, the date of the event de-
9 scribed in clause (i) or (ii) of paragraph (1)(B).

10 “(3) RELINQUISHMENT OF CITIZENSHIP.—A
11 citizen shall be treated as relinquishing United
12 States citizenship on the earliest of—

13 “(A) the date the individual renounces
14 such individual’s United States nationality be-
15 fore a diplomatic or consular officer of the
16 United States pursuant to paragraph (5) of sec-
17 tion 349(a) of the Immigration and Nationality
18 Act (8 U.S.C. 1481(a)(5)),

19 “(B) the date the individual furnishes to
20 the United States Department of State a signed
21 statement of voluntary relinquishment of
22 United States nationality confirming the per-
23 formance of an act of expatriation specified in
24 paragraph (1), (2), (3), or (4) of section 349(a)

1 of the Immigration and Nationality Act (8
2 U.S.C. 1481(a)(1)–(4)),

3 “(C) the date the United States Depart-
4 ment of State issues to the individual a certifi-
5 cate of loss of nationality, or

6 “(D) the date a court of the United States
7 cancels a naturalized citizen’s certificate of nat-
8 uralization.

9 Subparagraph (A) or (B) shall not apply to any indi-
10 vidual unless the renunciation or voluntary relin-
11 quishment is subsequently approved by the issuance
12 to the individual of a certificate of loss of nationality
13 by the United States Department of State.

14 “(4) LONG-TERM RESIDENT.—The term ‘long-
15 term resident’ has the meaning given to such term
16 by section 877(e)(2).

17 “(f) SPECIAL RULES APPLICABLE TO BENE-
18 FICIARIES’ INTERESTS IN TRUST.—

19 “(1) IN GENERAL.—Except as provided in para-
20 graph (2), if an individual is determined under para-
21 graph (3) to hold an interest in a trust on the day
22 before the expatriation date—

23 “(A) the individual shall not be treated as
24 having sold such interest,

1 “(B) such interest shall be treated as a
2 separate share in the trust, and

3 “(C)(i) such separate share shall be treat-
4 ed as a separate trust consisting of the assets
5 allocable to such share,

6 “(ii) the separate trust shall be treated as
7 having sold its assets on the day before the ex-
8 patriation date for their fair market value and
9 as having distributed all of its assets to the in-
10 dividual as of such time, and

11 “(iii) the individual shall be treated as hav-
12 ing recontributed the assets to the separate
13 trust.

14 Subsection (a)(2) shall apply to any income, gain, or
15 loss of the individual arising from a distribution de-
16 scribed in subparagraph (C)(ii). In determining the
17 amount of such distribution, proper adjustments
18 shall be made for liabilities of the trust allocable to
19 an individual’s share in the trust.

20 “(2) SPECIAL RULES FOR INTERESTS IN QUALI-
21 FIED TRUSTS.—

22 “(A) IN GENERAL.—If the trust interest
23 described in paragraph (1) is an interest in a
24 qualified trust—

1 “(i) paragraph (1) and subsection (a)
2 shall not apply, and

3 “(ii) in addition to any other tax im-
4 posed by this title, there is hereby imposed
5 on each distribution with respect to such
6 interest a tax in the amount determined
7 under subparagraph (B).

8 “(B) AMOUNT OF TAX.—The amount of
9 tax under subparagraph (A)(ii) shall be equal to
10 the lesser of—

11 “(i) the highest rate of tax imposed by
12 section 1(e) for the taxable year which in-
13 cludes the day before the expatriation date,
14 multiplied by the amount of the distribu-
15 tion, or

16 “(ii) the balance in the deferred tax
17 account immediately before the distribution
18 determined without regard to any increases
19 under subparagraph (C)(ii) after the 30th
20 day preceding the distribution.

21 “(C) DEFERRED TAX ACCOUNT.—For pur-
22 poses of subparagraph (B)(ii)—

23 “(i) OPENING BALANCE.—The open-
24 ing balance in a deferred tax account with
25 respect to any trust interest is an amount

1 equal to the tax which would have been im-
2 posed on the allocable expatriation gain
3 with respect to the trust interest if such
4 gain had been included in gross income
5 under subsection (a).

6 “(ii) INCREASE FOR INTEREST.—The
7 balance in the deferred tax account shall
8 be increased by the amount of interest de-
9 termined (on the balance in the account at
10 the time the interest accrues), for periods
11 after the 90th day after the expatriation
12 date, by using the rates and method appli-
13 cable under section 6621 for underpay-
14 ments of tax for such periods, except that
15 section 6621(a)(2) shall be applied by sub-
16 stituting ‘5 percentage points’ for ‘3 per-
17 centage points’ in subparagraph (B) there-
18 of.

19 “(iii) DECREASE FOR TAXES PRE-
20 VIOUSLY PAID.—The balance in the tax de-
21 ferred account shall be reduced—

22 “(I) by the amount of taxes im-
23 posed by subparagraph (A) on any
24 distribution to the person holding the
25 trust interest, and

1 “(II) in the case of a person
2 holding a nonvested interest, to the
3 extent provided in regulations, by the
4 amount of taxes imposed by subpara-
5 graph (A) on distributions from the
6 trust with respect to nonvested inter-
7 ests not held by such person.

8 “(D) ALLOCABLE EXPATRIATION GAIN.—
9 For purposes of this paragraph, the allocable
10 expatriation gain with respect to any bene-
11 ficiary’s interest in a trust is the amount of
12 gain which would be allocable to such bene-
13 ficiary’s vested and nonvested interests in the
14 trust if the beneficiary held directly all assets
15 allocable to such interests.

16 “(E) TAX DEDUCTED AND WITHHELD.—
17 “(i) IN GENERAL.—The tax imposed
18 by subparagraph (A)(ii) shall be deducted
19 and withheld by the trustees from the dis-
20 tribution to which it relates.

21 “(ii) EXCEPTION WHERE FAILURE TO
22 WAIVE TREATY RIGHTS.—If an amount
23 may not be deducted and withheld under
24 clause (i) by reason of the distributee fail-

1 ing to waive any treaty right with respect
2 to such distribution—

3 “(I) the tax imposed by subpara-
4 graph (A)(ii) shall be imposed on the
5 trust and each trustee shall be person-
6 ally liable for the amount of such tax,
7 and

8 “(II) any other beneficiary of the
9 trust shall be entitled to recover from
10 the distributee the amount of such tax
11 imposed on the other beneficiary.

12 “(F) DISPOSITION.—If a trust ceases to be
13 a qualified trust at any time, a covered expa-
14 triate disposes of an interest in a qualified
15 trust, or a covered expatriate holding an inter-
16 est in a qualified trust dies, then, in lieu of the
17 tax imposed by subparagraph (A)(ii), there is
18 hereby imposed a tax equal to the lesser of—

19 “(i) the tax determined under para-
20 graph (1) as if the day before the expatria-
21 tion date were the date of such cessation,
22 disposition, or death, whichever is applica-
23 ble, or

24 “(ii) the balance in the tax deferred
25 account immediately before such date.

1 Such tax shall be imposed on the trust and
2 each trustee shall be personally liable for the
3 amount of such tax and any other beneficiary
4 of the trust shall be entitled to recover from the
5 covered expatriate or the estate the amount of
6 such tax imposed on the other beneficiary.

7 “(G) DEFINITIONS AND SPECIAL RULES.—
8 For purposes of this paragraph—

9 “(i) QUALIFIED TRUST.—The term
10 ‘qualified trust’ means a trust which is de-
11 scribed in section 7701(a)(30)(E).

12 “(ii) VESTED INTEREST.—The term
13 ‘vested interest’ means any interest which,
14 as of the day before the expatriation date,
15 is vested in the beneficiary.

16 “(iii) NONVESTED INTEREST.—The
17 term ‘nonvested interest’ means, with re-
18 spect to any beneficiary, any interest in a
19 trust which is not a vested interest. Such
20 interest shall be determined by assuming
21 the maximum exercise of discretion in
22 favor of the beneficiary and the occurrence
23 of all contingencies in favor of the bene-
24 ficiary.

1 “(iv) ADJUSTMENTS.—The Secretary
2 may provide for such adjustments to the
3 bases of assets in a trust or a deferred tax
4 account, and the timing of such adjust-
5 ments, in order to ensure that gain is
6 taxed only once.

7 “(v) COORDINATION WITH RETIRE-
8 MENT PLAN RULES.—This subsection shall
9 not apply to an interest in a trust which
10 is part of a retirement plan to which sub-
11 section (d)(2) applies.

12 “(3) DETERMINATION OF BENEFICIARIES’ IN-
13 TEREST IN TRUST.—

14 “(A) DETERMINATIONS UNDER PARA-
15 GRAPH (1).—For purposes of paragraph (1), a
16 beneficiary’s interest in a trust shall be based
17 upon all relevant facts and circumstances, in-
18 cluding the terms of the trust instrument and
19 any letter of wishes or similar document, histor-
20 ical patterns of trust distributions, and the ex-
21 istence of and functions performed by a trust
22 protector or any similar adviser.

23 “(B) OTHER DETERMINATIONS.—For pur-
24 poses of this section—

1 “(i) CONSTRUCTIVE OWNERSHIP.—If
2 a beneficiary of a trust is a corporation,
3 partnership, trust, or estate, the share-
4 holders, partners, or beneficiaries shall be
5 deemed to be the trust beneficiaries for
6 purposes of this section.

7 “(ii) TAXPAYER RETURN POSITION.—
8 A taxpayer shall clearly indicate on its in-
9 come tax return—

10 “(I) the methodology used to de-
11 termine that taxpayer’s trust interest
12 under this section, and

13 “(II) if the taxpayer knows (or
14 has reason to know) that any other
15 beneficiary of such trust is using a
16 different methodology to determine
17 such beneficiary’s trust interest under
18 this section.

19 “(g) TERMINATION OF DEFERRALS, ETC.—In the
20 case of any covered expatriate, notwithstanding any other
21 provision of this title—

22 “(1) any period during which recognition of in-
23 come or gain is deferred shall terminate on the day
24 before the expatriation date, and

1 “(2) any extension of time for payment of tax
2 shall cease to apply on the day before the expatria-
3 tion date and the unpaid portion of such tax shall
4 be due and payable at the time and in the manner
5 prescribed by the Secretary.

6 “(h) IMPOSITION OF TENTATIVE TAX.—

7 “(1) IN GENERAL.—If an individual is required
8 to include any amount in gross income under sub-
9 section (a) for any taxable year, there is hereby im-
10 posed, immediately before the expatriation date, a
11 tax in an amount equal to the amount of tax which
12 would be imposed if the taxable year were a short
13 taxable year ending on the expatriation date.

14 “(2) DUE DATE.—The due date for any tax im-
15 posed by paragraph (1) shall be the 90th day after
16 the expatriation date.

17 “(3) TREATMENT OF TAX.—Any tax paid under
18 paragraph (1) shall be treated as a payment of the
19 tax imposed by this chapter for the taxable year to
20 which subsection (a) applies.

21 “(4) DEFERRAL OF TAX.—The provisions of
22 subsection (b) shall apply to the tax imposed by this
23 subsection to the extent attributable to gain includ-
24 ible in gross income by reason of this section.

1 “(i) SPECIAL LIENS FOR DEFERRED TAX
2 AMOUNTS.—

3 “(1) IMPOSITION OF LIEN.—

4 “(A) IN GENERAL.—If a covered expatriate
5 makes an election under subsection (a)(4) or
6 (b) which results in the deferral of any tax im-
7 posed by reason of subsection (a), the deferred
8 amount (including any interest, additional
9 amount, addition to tax, assessable penalty, and
10 costs attributable to the deferred amount) shall
11 be a lien in favor of the United States on all
12 property of the expatriate located in the United
13 States (without regard to whether this section
14 applies to the property).

15 “(B) DEFERRED AMOUNT.—For purposes
16 of this subsection, the deferred amount is the
17 amount of the increase in the covered expatri-
18 ate’s income tax which, but for the election
19 under subsection (a)(4) or (b), would have oc-
20 curred by reason of this section for the taxable
21 year including the expatriation date.

22 “(2) PERIOD OF LIEN.—The lien imposed by
23 this subsection shall arise on the expatriation date
24 and continue until—

1 “(A) the liability for tax by reason of this
2 section is satisfied or has become unenforceable
3 by reason of lapse of time, or

4 “(B) it is established to the satisfaction of
5 the Secretary that no further tax liability may
6 arise by reason of this section.

7 “(3) CERTAIN RULES APPLY.—The rules set
8 forth in paragraphs (1), (3), and (4) of section
9 6324A(d) shall apply with respect to the lien im-
10 posed by this subsection as if it were a lien imposed
11 by section 6324A.

12 “(j) REGULATIONS.—The Secretary shall prescribe
13 such regulations as may be necessary or appropriate to
14 carry out the purposes of this section.”.

15 (b) INCLUSION IN INCOME OF GIFTS AND BEQUESTS
16 RECEIVED BY UNITED STATES CITIZENS AND RESIDENTS
17 FROM EXPATRIATES.—Section 102 (relating to gifts, etc.
18 not included in gross income) is amended by adding at
19 the end the following new subsection:

20 “(d) GIFTS AND INHERITANCES FROM COVERED EX-
21 PATRIATES.—

22 “(1) IN GENERAL.—Subsection (a) shall not ex-
23 clude from gross income the value of any property
24 acquired by gift, bequest, devise, or inheritance from
25 a covered expatriate after the expatriation date. For

1 purposes of this subsection, any term used in this
 2 subsection which is also used in section 877A shall
 3 have the same meaning as when used in section
 4 877A.

5 “(2) EXCEPTIONS FOR TRANSFERS OTHERWISE
 6 SUBJECT TO ESTATE OR GIFT TAX.—Paragraph (1)
 7 shall not apply to any property if either—

8 “(A) the gift, bequest, devise, or inherit-
 9 ance is—

10 “(i) shown on a timely filed return of
 11 tax imposed by chapter 12 as a taxable gift
 12 by the covered expatriate, or

13 “(ii) included in the gross estate of
 14 the covered expatriate for purposes of
 15 chapter 11 and shown on a timely filed re-
 16 turn of tax imposed by chapter 11 of the
 17 estate of the covered expatriate, or

18 “(B) no such return was timely filed but
 19 no such return would have been required to be
 20 filed even if the covered expatriate were a cit-
 21 izen or long-term resident of the United
 22 States.”.

23 (c) DEFINITION OF TERMINATION OF UNITED
 24 STATES CITIZENSHIP.—Section 7701(a) is amended by
 25 adding at the end the following new paragraph:

1 “(48) TERMINATION OF UNITED STATES CITI-
2 ZENSHIP.—

3 “(A) IN GENERAL.—An individual shall
4 not cease to be treated as a United States citi-
5 zen before the date on which the individual’s
6 citizenship is treated as relinquished under sec-
7 tion 877A(e)(3).

8 “(B) DUAL CITIZENS.—Under regulations
9 prescribed by the Secretary, subparagraph (A)
10 shall not apply to an individual who became at
11 birth a citizen of the United States and a citi-
12 zen of another country.”.

13 (d) INELIGIBILITY FOR VISA OR ADMISSION TO
14 UNITED STATES.—

15 (1) IN GENERAL.—Section 212(a)(10)(E) of the
16 Immigration and Nationality Act (8 U.S.C.
17 1182(a)(10)(E)) is amended to read as follows:

18 “(E) FORMER CITIZENS NOT IN COMPLI-
19 ANCE WITH EXPATRIATION REVENUE PROVI-
20 SIONS.—Any alien who is a former citizen of
21 the United States who relinquishes United
22 States citizenship (within the meaning of sec-
23 tion 877A(e)(3) of the Internal Revenue Code
24 of 1986) and who is not in compliance with sec-

1 tion 877A of such Code (relating to expatria-
2 tion).”.

3 (2) AVAILABILITY OF INFORMATION.—

4 (A) IN GENERAL.—Section 6103(l) (relat-
5 ing to disclosure of returns and return informa-
6 tion for purposes other than tax administration)
7 is amended by adding at the end the following
8 new paragraph:

9 “(19) DISCLOSURE TO DENY VISA OR ADMIS-
10 SION TO CERTAIN EXPATRIATES.—Upon written re-
11 quest of the Attorney General or the Attorney Gen-
12 eral’s delegate, the Secretary shall disclose whether
13 an individual is in compliance with section 877A
14 (and if not in compliance, any items of noncompli-
15 ance) to officers and employees of the Federal agen-
16 cy responsible for administering section
17 212(a)(10)(E) of the Immigration and Nationality
18 Act solely for the purpose of, and to the extent nec-
19 essary in, administering such section
20 212(a)(10)(E).”.

21 (B) SAFEGUARDS.—

22 (i) TECHNICAL AMENDMENTS.—Para-
23 graph (4) of section 6103(p) of the Inter-
24 nal Revenue Code of 1986, as amended by
25 section 202(b)(2)(B) of the Trade Act of

1 2002 (Public Law 107–210; 116 Stat.
2 961), is amended by striking “or (17)”
3 after “any other person described in sub-
4 section (l)(16)” each place it appears and
5 inserting “or (18)”.

6 (ii) CONFORMING AMENDMENTS.—
7 Section 6103(p)(4) (relating to safe-
8 guards), as amended by clause (i), is
9 amended by striking “or (18)” after “any
10 other person described in subsection
11 (l)(16)” each place it appears and insert-
12 ing “(18), or (19)”.

13 (3) EFFECTIVE DATES.—

14 (A) IN GENERAL.—Except as provided in
15 subparagraph (B), the amendments made by
16 this subsection shall apply to individuals who
17 relinquish United States citizenship on or after
18 the date of the enactment of this Act.

19 (B) TECHNICAL AMENDMENTS.—The
20 amendments made by paragraph (2)(B)(i) shall
21 take effect as if included in the amendments
22 made by section 202(b)(2)(B) of the Trade Act
23 of 2002 (Public Law 107–210; 116 Stat. 961).

24 (e) CONFORMING AMENDMENTS.—

1 (1) Section 877 is amended by adding at the
2 end the following new subsection:

3 “(g) APPLICATION.—This section shall not apply to
4 an expatriate (as defined in section 877A(e)) whose expa-
5 triation date (as so defined) occurs on or after February
6 5, 2003.”.

7 (2) Section 2107 is amended by adding at the
8 end the following new subsection:

9 “(f) APPLICATION.—This section shall not apply to
10 any expatriate subject to section 877A.”.

11 (3) Section 2501(a)(3) is amended by adding at
12 the end the following new subparagraph:

13 “(F) APPLICATION.—This paragraph shall
14 not apply to any expatriate subject to section
15 877A.”.

16 (4)(A) Paragraph (1) of section 6039G(d) is
17 amended by inserting “or 877A” after “section
18 877”.

19 (B) The second sentence of section 6039G(e) is
20 amended by inserting “or who relinquishes United
21 States citizenship (within the meaning of section
22 877A(e)(3))” after “877(a)”.

23 (C) Section 6039G(f) is amended by inserting
24 “or 877A(e)(2)(B)” after “877(e)(1)”.

1 (f) CLERICAL AMENDMENT.—The table of sections
2 for subpart A of part II of subchapter N of chapter 1
3 is amended by inserting after the item relating to section
4 877 the following new item:

“Sec. 877A. Tax responsibilities of expatriation.”.

5 (g) EFFECTIVE DATE.—

6 (1) IN GENERAL.—Except as provided in this
7 subsection, the amendments made by this section
8 shall apply to expatriates (within the meaning of
9 section 877A(e) of the Internal Revenue Code of
10 1986, as added by this section) whose expatriation
11 date (as so defined) occurs on or after February 5,
12 2003.

13 (2) GIFTS AND BEQUESTS.—Section 102(d) of
14 the Internal Revenue Code of 1986 (as added by
15 subsection (b)) shall apply to gifts and bequests re-
16 ceived on or after February 5, 2003, from an indi-
17 vidual or the estate of an individual whose expatria-
18 tion date (as so defined) occurs after such date.

19 (3) DUE DATE FOR TENTATIVE TAX.—The due
20 date under section 877A(h)(2) of the Internal Rev-
21 enue Code of 1986, as added by this section, shall
22 in no event occur before the 90th day after the date
23 of the enactment of this Act.

1 **SEC. 242. TAX TREATMENT OF INVERTED CORPORATE EN-**
2 **TITIES.**

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

6 **“SEC. 7874. RULES RELATING TO INVERTED CORPORATE**
7 **ENTITIES.**

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

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

15 “(2) INVERTED DOMESTIC CORPORATION.—For
16 purposes of this section, a foreign incorporated enti-
17 ty shall be treated as an inverted domestic corpora-
18 tion if, pursuant to a plan (or a series of related
19 transactions)—

20 “(A) the entity completes after March 20,
21 2002, the direct or indirect acquisition of sub-
22 stantially all of the properties held directly or
23 indirectly by a domestic corporation or substan-
24 tially all of the properties constituting a trade
25 or business of a domestic partnership,

1 “(B) after the acquisition at least 80 per-
2 cent of the stock (by vote or value) of the entity
3 is held—

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

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

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

22 Except as provided in regulations, an acquisition of
23 properties of a domestic corporation shall not be
24 treated as described in subparagraph (A) if none of
25 the corporation’s stock was readily tradeable on an

1 established securities market at any time during the
2 4-year period ending on the date of the acquisition.

3 “(b) PRESERVATION OF DOMESTIC TAX BASE IN
4 CERTAIN INVERSION TRANSACTIONS TO WHICH SUB-
5 SECTION (a) DOES NOT APPLY.—

6 “(1) IN GENERAL.—If a foreign incorporated
7 entity would be treated as an inverted domestic cor-
8 poration with respect to an acquired entity if ei-
9 ther—

10 “(A) subsection (a)(2)(A) were applied by
11 substituting ‘after December 31, 1996, and on
12 or before March 20, 2002’ for ‘after March 20,
13 2002’ and subsection (a)(2)(B) were applied by
14 substituting ‘more than 50 percent’ for ‘at least
15 80 percent’, or

16 “(B) subsection (a)(2)(B) were applied by
17 substituting ‘more than 50 percent’ for ‘at least
18 80 percent’,

19 then the rules of subsection (c) shall apply to any
20 inversion gain of the acquired entity during the ap-
21 plicable period and the rules of subsection (d) shall
22 apply to any related party transaction of the ac-
23 quired entity during the applicable period. This sub-
24 section shall not apply for any taxable year if sub-

1 section (a) applies to such foreign incorporated enti-
2 ty for such taxable year.

3 “(2) ACQUIRED ENTITY.—For purposes of this
4 section—

5 “(A) IN GENERAL.—The term ‘acquired
6 entity’ means the domestic corporation or part-
7 nership substantially all of the properties of
8 which are directly or indirectly acquired in an
9 acquisition described in subsection (a)(2)(A) to
10 which this subsection applies.

11 “(B) AGGREGATION RULES.—Any domes-
12 tic person bearing a relationship described in
13 section 267(b) or 707(b) to an acquired entity
14 shall be treated as an acquired entity with re-
15 spect to the acquisition described in subpara-
16 graph (A).

17 “(3) APPLICABLE PERIOD.—For purposes of
18 this section—

19 “(A) IN GENERAL.—The term ‘applicable
20 period’ means the period—

21 “(i) beginning on the first date prop-
22 erties are acquired as part of the acquisi-
23 tion described in subsection (a)(2)(A) to
24 which this subsection applies, and

1 “(ii) ending on the date which is 10
2 years after the last date properties are ac-
3 quired as part of such acquisition.

4 “(B) SPECIAL RULE FOR INVERSIONS OC-
5 CURRING BEFORE MARCH 21, 2002.—In the case
6 of any acquired entity to which paragraph
7 (1)(A) applies, the applicable period shall be the
8 10-year period beginning on January 1, 2003.

9 “(c) TAX ON INVERSION GAINS MAY NOT BE OFF-
10 SET.—If subsection (b) applies—

11 “(1) IN GENERAL.—The taxable income of an
12 acquired entity (or any expanded affiliated group
13 which includes such entity) for any taxable year
14 which includes any portion of the applicable period
15 shall in no event be less than the inversion gain of
16 the entity for the taxable year.

17 “(2) CREDITS NOT ALLOWED AGAINST TAX ON
18 INVERSION GAIN.—Credits shall be allowed against
19 the tax imposed by this chapter on an acquired enti-
20 ty for any taxable year described in paragraph (1)
21 only to the extent such tax exceeds the product of—

22 “(A) the amount of the inversion gain for
23 the taxable year, and

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

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

4 “(3) SPECIAL RULES FOR PARTNERSHIPS.—In
5 the case of an acquired entity which is a partner-
6 ship—

7 “(A) the limitations of this subsection shall
8 apply at the partner rather than the partner-
9 ship level,

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

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

15 “(ii) income or gain required to be
16 recognized for the taxable year by the part-
17 ner under section 367(a), 741, or 1001, or
18 under any other provision of chapter 1, by
19 reason of the transfer during the applica-
20 ble period of any partnership interest of
21 the partner in such partnership to the for-
22 eign incorporated entity, and

23 “(C) the highest rate of tax specified in
24 the rate schedule applicable to the partner

1 under chapter 1 shall be substituted for the
2 rate of tax under paragraph (2)(B).

3 “(4) INVERSION GAIN.—For purposes of this
4 section, the term ‘inversion gain’ means any income
5 or gain required to be recognized under section 304,
6 311(b), 367, 1001, or 1248, or under any other pro-
7 vision of chapter 1, by reason of the transfer during
8 the applicable period of stock or other properties by
9 an acquired entity—

10 “(A) as part of the acquisition described in
11 subsection (a)(2)(A) to which subsection (b) ap-
12 plies, or

13 “(B) after such acquisition to a foreign re-
14 lated person.

15 The Secretary may provide that income or gain from
16 the sale of inventories or other transactions in the
17 ordinary course of a trade or business shall not be
18 treated as inversion gain under subparagraph (B) to
19 the extent the Secretary determines such treatment
20 would not be inconsistent with the purposes of this
21 section.

22 “(5) COORDINATION WITH SECTION 172 AND
23 MINIMUM TAX.—Rules similar to the rules of para-
24 graphs (3) and (4) of section 860E(a) shall apply
25 for purposes of this section.

1 “(6) STATUTE OF LIMITATIONS.—

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

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

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

20 “(ii) such year ends before the taxable
21 year in which the acquisition described in
22 subsection (a)(2)(A) is completed.

23 “(d) SPECIAL RULES APPLICABLE TO RELATED
24 PARTY TRANSACTIONS.—

1 “(1) ANNUAL APPLICATION FOR AGREEMENTS
2 ON RETURN POSITIONS.—

3 “(A) IN GENERAL.—Each acquired entity
4 to which subsection (b) applies shall file with
5 the Secretary an application for an approval
6 agreement under subparagraph (D) for each
7 taxable year which includes a portion of the ap-
8 plicable period. Such application shall be filed
9 at such time and manner, and shall contain
10 such information, as the Secretary may pre-
11 scribe.

12 “(B) SECRETARIAL ACTION.—Within 90
13 days of receipt of an application under subpara-
14 graph (A) (or such longer period as the Sec-
15 retary and entity may agree upon), the Sec-
16 retary shall—

17 “(i) enter into an agreement described
18 in subparagraph (D) for the taxable year
19 covered by the application,

20 “(ii) notify the entity that the Sec-
21 retary has determined that the application
22 was filed in good faith and substantially
23 complies with the requirements for the ap-
24 plication under subparagraph (A), or

1 “(iii) notify the entity that the Sec-
2 retary has determined that the application
3 was not filed in good faith or does not sub-
4 stantially comply with such requirements.

5 If the Secretary fails to act within the time pre-
6 scribed under the preceding sentence, the entity
7 shall be treated for purposes of this paragraph
8 as having received notice under clause (ii).

9 “(C) FAILURES TO COMPLY.—If an ac-
10 quired entity fails to file an application under
11 subparagraph (A), or the acquired entity re-
12 ceives a notice under subparagraph (B)(iii), for
13 any taxable year, then for such taxable year—

14 “(i) there shall not be allowed any de-
15 duction, or addition to basis or cost of
16 goods sold, for amounts paid or incurred,
17 or losses incurred, by reason of a trans-
18 action between the acquired entity and a
19 foreign related person,

20 “(ii) any transfer or license of intan-
21 gible property (as defined in section
22 936(h)(3)(B)) between the acquired entity
23 and a foreign related person shall be dis-
24 regarded, and

1 “(iii) any cost-sharing arrangement
2 between the acquired entity and a foreign
3 related person shall be disregarded.

4 “(D) APPROVAL AGREEMENT.—For pur-
5 poses of subparagraph (A), the term ‘approval
6 agreement’ means a prefilling, advance pricing,
7 or other agreement specified by the Secretary
8 which contains such provisions as the Secretary
9 determines necessary to ensure that the require-
10 ments of sections 163(j), 267(a)(3), 482, and
11 845, and any other provision of this title appli-
12 cable to transactions between related persons
13 and specified by the Secretary, are met.

14 “(E) TAX COURT REVIEW.—

15 “(i) IN GENERAL.—The Tax Court
16 shall have jurisdiction over any action
17 brought by an acquired entity receiving a
18 notice under subparagraph (B)(iii) to de-
19 termine whether the issuance of the notice
20 was an abuse of discretion, but only if the
21 action is brought within 30 days after the
22 date of the mailing (determined under
23 rules similar to section 6213) of the notice.

24 “(ii) COURT ACTION.—The Tax Court
25 shall issue its decision within 30 days after

1 the filing of the action under clause (i) and
2 may order the Secretary to issue a notice
3 described in subparagraph (B)(ii).

4 “(iii) REVIEW.—An order of the Tax
5 Court under this subparagraph shall be re-
6 viewable in the same manner as any other
7 decision of the Tax Court.

8 “(2) MODIFICATIONS OF LIMITATION ON INTER-
9 EST DEDUCTION.—In the case of an acquired entity
10 to which subsection (b) applies, section 163(j) shall
11 be applied—

12 “(A) without regard to paragraph
13 (2)(A)(ii) thereof, and

14 “(B) by substituting ‘25 percent’ for ‘50
15 percent’ each place it appears in paragraph
16 (2)(B) thereof.

17 “(e) OTHER DEFINITIONS AND SPECIAL RULES.—
18 For purposes of this section—

19 “(1) RULES FOR APPLICATION OF SUBSECTION
20 (a)(2).—In applying subsection (a)(2) for purposes of
21 subsections (a) and (b), the following rules shall
22 apply:

23 “(A) CERTAIN STOCK DISREGARDED.—
24 There shall not be taken into account in deter-

1 mining ownership for purposes of subsection
2 (a)(2)(B)—

3 “(i) stock held by members of the ex-
4 panded affiliated group which includes the
5 foreign incorporated entity, or

6 “(ii) stock of such entity which is sold
7 in a public offering or private placement
8 related to the acquisition described in sub-
9 section (a)(2)(A).

10 “(B) PLAN DEEMED IN CERTAIN CASES.—

11 If a foreign incorporated entity acquires directly
12 or indirectly substantially all of the properties
13 of a domestic corporation or partnership during
14 the 4-year period beginning on the date which
15 is 2 years before the ownership requirements of
16 subsection (a)(2)(B) are met with respect to
17 such domestic corporation or partnership, such
18 actions shall be treated as pursuant to a plan.

19 “(C) CERTAIN TRANSFERS DIS-
20 REGARDED.—The transfer of properties or li-
21 abilities (including by contribution or distribu-
22 tion) shall be disregarded if such transfers are
23 part of a plan a principal purpose of which is
24 to avoid the purposes of this section.

1 “(D) SPECIAL RULE FOR RELATED PART-
2 NERSHIPS.—For purposes of applying sub-
3 section (a)(2) to the acquisition of a domestic
4 partnership, except as provided in regulations,
5 all partnerships which are under common con-
6 trol (within the meaning of section 482) shall
7 be treated as 1 partnership.

8 “(E) TREATMENT OF CERTAIN RIGHTS.—
9 The Secretary shall prescribe such regulations
10 as may be necessary—

11 “(i) to treat warrants, options, con-
12 tracts to acquire stock, convertible debt in-
13 struments, and other similar interests as
14 stock, and

15 “(ii) to treat stock as not stock.

16 “(2) EXPANDED AFFILIATED GROUP.—The
17 term ‘expanded affiliated group’ means an affiliated
18 group as defined in section 1504(a) but without re-
19 gard to section 1504(b)(3), except that section
20 1504(a) shall be applied by substituting ‘more than
21 50 percent’ for ‘at least 80 percent’ each place it ap-
22 pears.

23 “(3) FOREIGN INCORPORATED ENTITY.—The
24 term ‘foreign incorporated entity’ means any entity
25 which is, or but for subsection (a)(1) would be,

1 treated as a foreign corporation for purposes of this
2 title.

3 “(4) FOREIGN RELATED PERSON.—The term
4 ‘foreign related person’ means, with respect to any
5 acquired entity, a foreign person which—

6 “(A) bears a relationship to such entity de-
7 scribed in section 267(b) or 707(b), or

8 “(B) is under the same common control
9 (within the meaning of section 482) as such en-
10 tity.

11 “(5) SUBSEQUENT ACQUISITIONS BY UNRE-
12 LATED DOMESTIC CORPORATIONS.—

13 “(A) IN GENERAL.—Subject to such condi-
14 tions, limitations, and exceptions as the Sec-
15 retary may prescribe, if, after an acquisition de-
16 scribed in subsection (a)(2)(A) to which sub-
17 section (b) applies, a domestic corporation stock
18 of which is traded on an established securities
19 market acquires directly or indirectly any prop-
20 erties of one or more acquired entities in a
21 transaction with respect to which the require-
22 ments of subparagraph (B) are met, this sec-
23 tion shall cease to apply to any such acquired
24 entity with respect to which such requirements
25 are met.

1 “(B) REQUIREMENTS.—The requirements
2 of the subparagraph are met with respect to a
3 transaction involving any acquisition described
4 in subparagraph (A) if—

5 “(i) before such transaction the do-
6 mestic corporation did not have a relation-
7 ship described in section 267(b) or 707(b),
8 and was not under common control (within
9 the meaning of section 482), with the ac-
10 quired entity, or any member of an ex-
11 panded affiliated group including such en-
12 tity, and

13 “(ii) after such transaction, such ac-
14 quired entity—

15 “(I) is a member of the same ex-
16 panded affiliated group which includes
17 the domestic corporation or has such
18 a relationship or is under such com-
19 mon control with any member of such
20 group, and

21 “(II) is not a member of, and
22 does not have such a relationship and
23 is not under such common control
24 with any member of, the expanded af-

1 filiated group which before such ac-
2 quisition included such entity.

3 “(f) REGULATIONS.—The Secretary shall provide
4 such regulations as are necessary to carry out this section,
5 including regulations providing for such adjustments to
6 the application of this section as are necessary to prevent
7 the avoidance of the purposes of this section, including the
8 avoidance of such purposes through—

9 “(1) the use of related persons, pass-through or
10 other noncorporate entities, or other intermediaries,
11 or

12 “(2) transactions designed to have persons
13 cease to be (or not become) members of expanded
14 affiliated groups or related persons.”.

15 (b) TREATMENT OF AGREEMENTS.—

16 (1) CONFIDENTIALITY.—

17 (A) TREATMENT AS RETURN INFORMA-
18 TION.—Section 6103(b)(2) (relating to return
19 information) is amended by striking “and” at
20 the end of subparagraph (C), by inserting
21 “and” at the end of subparagraph (D), and by
22 inserting after subparagraph (D) the following
23 new subparagraph:

24 “(E) any approval agreement under section
25 7874(d)(1) to which any preceding subpara-

1 graph does not apply and any background in-
2 formation related to the agreement or any ap-
3 plication for the agreement.”.

4 (B) EXCEPTION FROM PUBLIC INSPECTION
5 AS WRITTEN DETERMINATION.—Section
6 6110(b)(1)(B) is amended by striking “or (D)”
7 and inserting “, (D), or (E)”.

8 (2) REPORTING.—The Secretary of the Treas-
9 ury shall include with any report on advance pricing
10 agreements required to be submitted after the date
11 of the enactment of this Act under section 521(b) of
12 the Ticket to Work and Work Incentives Improve-
13 ment Act of 1999 (Public Law 106–170) a report
14 regarding approval agreements under section
15 7874(d)(1) of the Internal Revenue Code of 1986.
16 Such report shall include information similar to the
17 information required with respect to advance pricing
18 agreements and shall be treated for confidentiality
19 purposes in the same manner as the reports on ad-
20 vance pricing agreements are treated under section
21 521(b)(3) of such Act.

22 (c) INFORMATION REPORTING.—The Secretary of the
23 Treasury shall exercise the Secretary’s authority under the
24 Internal Revenue Code of 1986 to require entities involved
25 in transactions to which section 7874 of such Code (as

1 added by subsection (a)) applies to report to the Secretary,
 2 shareholders, partners, and such other persons as the Sec-
 3 retary may prescribe such information as is necessary to
 4 ensure the proper tax treatment of such transactions.

5 (d) CONFORMING AMENDMENT.—The table of sec-
 6 tions for subchapter C of chapter 80 is amended by adding
 7 at the end the following new item:

“Sec. 7874. Rules relating to inverted corporate entities.”.

8 (e) TRANSITION RULE FOR CERTAIN REGULATED
 9 INVESTMENT COMPANIES AND UNIT INVESTMENT
 10 TRUSTS.—Notwithstanding section 7874 of the Internal
 11 Revenue Code of 1986 (as added by subsection (a)), a reg-
 12 ulated investment company, or other pooled fund or trust
 13 specified by the Secretary of the Treasury, may elect to
 14 recognize gain by reason of section 367(a) of such Code
 15 with respect to a transaction under which a foreign incor-
 16 porated entity is treated as an inverted domestic corpora-
 17 tion under section 7874(a) of such Code by reason of an
 18 acquisition completed after March 20, 2002, and before
 19 January 1, 2004.

20 **SEC. 243. EXCISE TAX ON STOCK COMPENSATION OF INSID-**
 21 **ERS IN INVERTED CORPORATIONS.**

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

1 **“CHAPTER 48—STOCK COMPENSATION OF**
 2 **INSIDERS IN INVERTED CORPORATIONS**

“Sec. 5000A. Stock compensation of insiders in inverted corporations.

3 **“SEC. 5000A. STOCK COMPENSATION OF INSIDERS IN IN-**
 4 **VERTED CORPORATIONS.**

5 “(a) IMPOSITION OF TAX.—In the case of an indi-
 6 vidual who is a disqualified individual with respect to any
 7 inverted corporation, there is hereby imposed on such per-
 8 son a tax equal to 20 percent of the value (determined
 9 under subsection (b)) of the specified stock compensation
 10 held (directly or indirectly) by or for the benefit of such
 11 individual or a member of such individual’s family (as de-
 12 fined in section 267) at any time during the 12-month
 13 period beginning on the date which is 6 months before
 14 the inversion date.

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

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

18 “(A) in the case of a stock option (or other
 19 similar right) or any stock appreciation right,
 20 the fair value of such option or right, and

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

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

1 “(A) in the case of specified stock com-
2 pensation held on the inversion date, on such
3 date,

4 “(B) in the case of such compensation
5 which is canceled during the 6 months before
6 the inversion date, on the day before such can-
7 cellation, and

8 “(C) in the case of such compensation
9 which is granted after the inversion date, on the
10 date such compensation is granted.

11 “(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN
12 RECOGNIZED.—Subsection (a) shall apply to any disquali-
13 fied individual with respect to an inverted corporation only
14 if gain (if any) on any stock in such corporation is recog-
15 nized in whole or part by any shareholder by reason of
16 the acquisition referred to in section 7874(a)(2)(A) (deter-
17 mined by substituting ‘July 10, 2002’ for ‘March 20,
18 2002’) with respect to such corporation.

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

21 “(1) any stock option which is exercised on the
22 inversion date or during the 6-month period before
23 such date and to the stock acquired in such exercise,
24 and

1 “(2) any specified stock compensation which is
2 sold, exchanged, or distributed during such period in
3 a transaction in which gain or loss is recognized in
4 full.

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

6 “(1) DISQUALIFIED INDIVIDUAL.—The term
7 ‘disqualified individual’ means, with respect to a cor-
8 poration, any individual who, at any time during the
9 12-month period beginning on the date which is 6
10 months before the inversion date—

11 “(A) is subject to the requirements of sec-
12 tion 16(a) of the Securities Exchange Act of
13 1934 with respect to such corporation or any
14 member of the expanded affiliated group which
15 includes such corporation, or

16 “(B) would be subject to such require-
17 ments if such corporation or member were an
18 issuer of equity securities referred to in such
19 section.

20 “(2) INVERTED CORPORATION; INVERSION
21 DATE.—

22 “(A) INVERTED CORPORATION.—The term
23 ‘inverted corporation’ means any corporation to
24 which subsection (a) or (b) of section 7874 ap-
25 plies determined—

1 “(i) by substituting ‘July 10, 2002’
2 for ‘March 20, 2002’ in section
3 7874(a)(2)(A), and

4 “(ii) without regard to subsection
5 (b)(1)(A).

6 Such term includes any predecessor or suc-
7 cessor of such a corporation.

8 “(B) INVERSION DATE.—The term ‘inver-
9 sion date’ means, with respect to a corporation,
10 the date on which the corporation first becomes
11 an inverted corporation.

12 “(3) SPECIFIED STOCK COMPENSATION.—

13 “(A) IN GENERAL.—The term ‘specified
14 stock compensation’ means payment (or right
15 to payment) granted by the inverted corpora-
16 tion (or by any member of the expanded affili-
17 ated group which includes such corporation) to
18 any person in connection with the performance
19 of services by a disqualified individual for such
20 corporation or member if the value of such pay-
21 ment or right is based on (or determined by ref-
22 erence to) the value (or change in value) of
23 stock in such corporation (or any such mem-
24 ber).

1 “(B) EXCEPTIONS.—Such term shall not
2 include—

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
9 term ‘expanded affiliated group’ means an affiliated
10 group (as defined in section 1504(a) without regard
11 to section 1504(b)(3)); except that section 1504(a)
12 shall be applied by substituting ‘more than 50 per-
13 cent’ for ‘at least 80 percent’ each place it appears.

14 “(f) SPECIAL RULES.—For purposes of this sec-
15 tion—

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

19 “(2) PAYMENT OR REIMBURSEMENT OF TAX BY
20 CORPORATION TREATED AS SPECIFIED STOCK COM-
21 PENSATION.—Any payment of the tax imposed by
22 this section directly or indirectly by the inverted cor-
23 poration or by any member of the expanded affili-
24 ated group which includes such corporation—

1 “(A) shall be treated as specified stock
2 compensation, and

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

5 “(3) CERTAIN RESTRICTIONS IGNORED.—
6 Whether there is specified stock compensation, and
7 the value thereof, shall be determined without regard
8 to any restriction other than a restriction which by
9 its terms will never lapse.

10 “(4) PROPERTY TRANSFERS.—Any transfer of
11 property shall be treated as a payment and any right
12 to a transfer of property shall be treated as a right
13 to a payment.

14 “(5) OTHER ADMINISTRATIVE PROVISIONS.—
15 For purposes of subtitle F, any tax imposed by this
16 section shall be treated as a tax imposed by subtitle
17 A.

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

21 (b) DENIAL OF DEDUCTION.—

22 (1) IN GENERAL.—Paragraph (6) of section
23 275(a) is amended by inserting “48,” after “46,”.

24 (2) \$1,000,000 LIMIT ON DEDUCTIBLE COM-
25 PENSATION REDUCED BY PAYMENT OF EXCISE TAX

1 ON SPECIFIED STOCK COMPENSATION.—Paragraph
 2 (4) of section 162(m) is amended by adding at the
 3 end the following new subparagraph:

4 “(G) COORDINATION WITH EXCISE TAX ON
 5 SPECIFIED STOCK COMPENSATION.—The dollar
 6 limitation contained in paragraph (1) with re-
 7 spect to any covered employee shall be reduced
 8 (but not below zero) by the amount of any pay-
 9 ment (with respect to such employee) of the tax
 10 imposed by section 5000A directly or indirectly
 11 by the inverted corporation (as defined in such
 12 section) or by any member of the expanded af-
 13 filiated group (as defined in such section) which
 14 includes such corporation.”.

15 (c) CONFORMING AMENDMENTS.—

16 (1) The last sentence of section 3121(v)(2)(A)
 17 is amended by inserting before the period “or to any
 18 specified stock compensation (as defined in section
 19 5000A) on which tax is imposed by section 5000A”.

20 (2) The table of chapters for subtitle D is
 21 amended by adding at the end the following new
 22 item:

“Chapter 48. Stock compensation of insiders in inverted corpora-
 tions.”.

23 (d) EFFECTIVE DATE.—The amendments made by
 24 this section shall take effect on July 11, 2002; except that

1 periods before such date shall not be taken into account
2 in applying the periods in subsections (a) and (e)(1) of
3 section 5000A of the Internal Revenue Code of 1986, as
4 added by this section.

5 **PART II—OTHER PROVISIONS**

6 **SEC. 245. EFFECTIVELY CONNECTED INCOME TO INCLUDE**
7 **CERTAIN FOREIGN SOURCE INCOME.**

8 (a) IN GENERAL.—Section 864(c)(4)(B) (relating to
9 treatment of income from sources without the United
10 States as effectively connected income) is amended by add-
11 ing at the end the following new flush sentence:

12 “Any income or gain which is equivalent to any
13 item of income or gain described in clause (i),
14 (ii), or (iii) shall be treated in the same manner
15 as such item for purposes of this subpara-
16 graph.”.

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

20 **SEC. 246. DETERMINATION OF BASIS OF AMOUNTS PAID**
21 **FROM FOREIGN PENSION PLANS.**

22 (a) IN GENERAL.—Section 72 (relating to annuities
23 and certain proceeds of endowment and life insurance con-
24 tracts) is amended by redesignating subsection (w) as sub

1 section (x) by inserting subsection (v) the following new
2 subsection:

3 “(w) DETERMINATION OF BASIS OF FOREIGN PEN-
4 SION PLANS.—Notwithstanding any other provision of
5 this section, for purposes of determining the portion of
6 any distribution from a foreign pension plan which is in-
7 cludible in gross income of the distributee, the investment
8 in the contract with respect to the plan shall not include
9 employer or employee contributions to the plan (or any
10 earnings on such contributions) unless such contributions
11 or earnings were subject to taxation by the United States
12 or any foreign government.”.

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

16 **SEC. 247. PREVENTION OF MISMATCHING OF INTEREST**
17 **AND ORIGINAL ISSUE DISCOUNT DEDUC-**
18 **TIONS AND INCOME INCLUSIONS IN TRANS-**
19 **ACTIONS WITH RELATED FOREIGN PERSONS.**

20 (a) ORIGINAL ISSUE DISCOUNT.—Section 163(e)(3)
21 (relating to special rule for original issue discount on obli-
22 gation held by related foreign person) is amended by re-
23 designating subparagraph (B) as subparagraph (C) and
24 by inserting after subparagraph (A) the following new sub-
25 paragraph:

1 “(B) SPECIAL RULE FOR CERTAIN FOR-
2 EIGN ENTITIES.—Notwithstanding subpara-
3 graph (A) (and any regulations thereunder), in
4 the case of any debt instrument having original
5 issue discount which is held by a related foreign
6 person which is a foreign personal holding com-
7 pany (as defined in section 552), a controlled
8 foreign corporation (as defined in section 957),
9 or a passive foreign investment company (as de-
10 fined in section 1297), a deduction shall be al-
11 lowable to the issuer with respect to such origi-
12 nal issue discount for any taxable year only to
13 the extent such original issue discount is in-
14 cluded during such taxable year in the gross in-
15 come of a United States person who owns
16 (within the meaning of section 958(a)) stock in
17 such corporation. For purposes of this subpara-
18 graph, the determination as to the proper allo-
19 cation of the original issue discount to share-
20 holders shall be made in such manner as the
21 Secretary may prescribe.”.

22 (b) INTEREST AND OTHER DEDUCTIBLE
23 AMOUNTS.—Section 267(a)(3) is amended—

24 (1) by striking “The Secretary” and inserting:

25 “(A) IN GENERAL.—The Secretary”, and

1 (2) by adding at the end the following new sub-
2 paragraph:

3 “(B) SPECIAL RULE FOR CERTAIN FOR-
4 EIGN ENTITIES.—Notwithstanding any regula-
5 tions issued under subparagraph (A), in the
6 case of any amount payable to a foreign per-
7 sonal holding company (as defined in section
8 552), a controlled foreign corporation (as de-
9 fined in section 957), or a passive foreign in-
10 vestment company (as defined in section 1297),
11 a deduction shall be allowable to the payor with
12 respect to such amount for any taxable year
13 only to the extent such amount is included dur-
14 ing such taxable year in the gross income of a
15 United States person who owns (within the
16 meaning of section 958(a)) stock in such cor-
17 poration. For purposes of this subparagraph,
18 the determination as to the proper allocation of
19 such amount to shareholders shall be made in
20 such manner as the Secretary may prescribe.”.

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to payments accrued on or after
23 May 8, 2003.

1 **Subtitle E—Other Revenue**
2 **Provisions**

3 **SEC. 251. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS**
4 **TRANSFERS.**

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

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

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

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

24 For purposes of subparagraph (C), the term ‘built-
25 in loss’ means the excess of the adjusted basis of the

1 property (determined without regard to subpara-
2 graph (C)(ii)) over its fair market value immediately
3 after the contribution.”.

4 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-
5 erty ON TRANSFER OF PARTNERSHIP INTEREST IF
6 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

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

13 (2) ADJUSTMENT.—Subsection (b) of section
14 743 is amended by inserting “or with respect to
15 which there is a substantial built-in loss immediately
16 after such transfer” after “section 754 is in effect”.

17 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743
18 is amended by adding at the end the following new
19 subsection:

20 “(d) SUBSTANTIAL BUILT-IN LOSS.—

21 “(1) IN GENERAL.—For purposes of this sec-
22 tion, a partnership has a substantial built-in loss
23 with respect to a transfer of an interest in a part-
24 nership if the transferee partner’s proportionate
25 share of the adjusted basis of the partnership prop-

1 erty exceeds by more than \$250,000 the basis of
2 such partner's interest in the partnership.

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

10 (4) CLERICAL AMENDMENTS.—

11 (A) The section heading for section 743 is
12 amended to read as follows:

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

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

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

20 (c) ADJUSTMENT TO BASIS OF UNDISTRIBUTED
21 PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL
22 BASIS REDUCTION.—

23 (1) ADJUSTMENT REQUIRED.—Subsection (a)
24 of section 734 (relating to optional adjustment to

1 basis of undistributed partnership property) is
2 amended by inserting before the period “or unless
3 there is a substantial basis reduction”.

4 (2) ADJUSTMENT.—Subsection (b) of section
5 734 is amended by inserting “or unless there is a
6 substantial basis reduction” after “section 754 is in
7 effect”.

8 (3) SUBSTANTIAL BASIS REDUCTION.—Section
9 734 is amended by adding at the end the following
10 new subsection:

11 “(d) SUBSTANTIAL BASIS REDUCTION.—

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

17 “(2) REGULATIONS.—

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

18 (4) CLERICAL AMENDMENTS.—

19 (A) The section heading for section 734 is
20 amended to read as follows:

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

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

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

9 (d) **EFFECTIVE DATES.—**

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

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

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

19 **SEC. 252. CLARIFICATION OF EXEMPTION FROM TAX FOR**
 20 **SMALL PROPERTY AND CASUALTY INSUR-**
 21 **ANCE COMPANIES.**

22 (a) **IN GENERAL.—**Section 501(c)(15)(A) is amended
 23 to read as follows:

1 “(A) Insurance companies or associations
2 other than life (including interinsurers and re-
3 ciprocal underwriters) if—

4 “(i) the gross receipts for the taxable
5 year do not exceed \$600,000, and

6 “(ii) more than 50 percent of such
7 gross receipts consist of premiums.”.

8 (b) CONTROLLED GROUP RULE.—Section
9 501(c)(15)(C) is amended by inserting “, except that in
10 applying section 1563 for purposes of section
11 831(b)(2)(B)(ii), subparagraphs (B) and (C) of section
12 1563(b)(2) shall be disregarded” before the period at the
13 end.

14 (c) CONFORMING AMENDMENT.—Clause (i) of sec-
15 tion 831(b)(2)(A) is amended by striking “exceed
16 \$350,000 but”.

17 (d) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to taxable years beginning after
19 December 31, 2003.

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