

109TH CONGRESS  
1ST SESSION

# H. R. 2625

To amend the Internal Revenue Code of 1986 to curb tax abuses by disallowing tax benefits claimed to arise from transactions without substantial economic substance, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

MAY 25, 2005

Mr. DOGGETT (for himself, Mr. LEVIN, Mr. STARK, Mr. McDERMOTT, Mr. NEAL of Massachusetts, Mr. McNULTY, Mr. LEWIS of Georgia, Mr. JEFFERSON, Mr. BECERRA, Mr. EMANUEL, Mr. ALLEN, Ms. BALDWIN, Mr. BERMAN, Mr. BROWN of Ohio, Mrs. CAPPES, Mr. CASE, Mr. CONYERS, Mr. COSTELLO, Mr. CROWLEY, Mr. DAVIS of Illinois, Mr. DEFazio, Ms. DEGETTE, Ms. DELAURO, Mr. FARR, Mr. FATAH, Mr. FILNER, Mr. GENE GREEN of Texas, Mr. GRIJALVA, Ms. JACKSON-LEE of Texas, Mr. KUCINICH, Ms. LEE, Mr. MARKEY, Mr. MCGOVERN, Mrs. MALONEY, Mr. GEORGE MILLER of California, Mr. NADLER, Mrs. NAPOLITANO, Mr. OBERSTAR, Mr. RYAN of Ohio, Mr. SABO, Ms. LORETTA SANCHEZ of California, Mr. SANDERS, Ms. SCHAKOWSKY, Mr. SHERMAN, Ms. SLAUGHTER, Mr. STRICKLAND, Ms. SOLIS, Mr. TAYLOR of Mississippi, Mr. TIERNEY, Mrs. JONES of Ohio, Ms. WATERS, and Mr. WAXMAN) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to curb tax abuses by disallowing tax benefits claimed to arise from transactions without substantial economic substance, 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,*

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

2 (a) **SHORT TITLE.**—This Act may be cited as the  
3 “Abusive Tax Shelter Shutdown and Taxpayer Account-  
4 ability Act of 2005”.

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

11 (c) **TABLE OF CONTENTS.**—The table of contents for  
12 this Act is as follows:

- Sec. 1. Short title; etc.
- Sec. 2. Findings and purpose.

**TITLE I—PROVISIONS DESIGNED TO CURTAIL TAX SHELTERS**

- Sec. 101. Clarification of economic substance doctrine.
- Sec. 102. Modification of penalty for failing to disclose reportable transaction.
- Sec. 103. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 104. Required disclosure by material advisors not subject to claim of confidentiality.
- Sec. 105. Understatement of taxpayer’s liability by income tax return preparer.
- Sec. 106. Frivolous tax submissions.
- Sec. 107. Denial of deduction for interest on Underpayments attributable to nondisclosed reportable and noneconomic substance transactions.

**TITLE II—OTHER PROVISIONS**

- Sec. 201. Expanded authority to disallow tax benefits under Section 269.
- Sec. 202. Modifications of certain rules relating to controlled foreign corporations.
- Sec. 203. Basis for determining loss always reduced by nontaxed portion of dividends.

13 **SEC. 2. FINDINGS AND PURPOSE.**

14 (a) **FINDINGS.**—The Congress hereby finds that:

1           (1) Many corporate tax shelter transactions are  
2 complicated ways of accomplishing nothing aside  
3 from claimed tax benefits, and the legal opinions  
4 justifying those transactions take an inappropriately  
5 narrow and restrictive view of well-developed court  
6 doctrines under which—

7           (A) the taxation of a transaction is deter-  
8 mined in accordance with its substance and not  
9 merely its form,

10           (B) transactions which have no significant  
11 effect on the taxpayer's economic or beneficial  
12 interests except for tax benefits are treated as  
13 sham transactions and disregarded,

14           (C) transactions involving multiple steps  
15 are collapsed when those steps have no substan-  
16 tial economic meaning and are merely designed  
17 to create tax benefits,

18           (D) transactions with no business purpose  
19 are not given effect, and

20           (E) in the absence of a specific congres-  
21 sional authorization, it is presumed that Con-  
22 gress did not intend a transaction to result in  
23 a negative tax where the taxpayer's economic  
24 position or rate of return is better after tax  
25 than before tax.

1           (2) Permitting aggressive and abusive tax shel-  
2           ters not only results in large revenue losses but also  
3           undermines voluntary compliance with the Internal  
4           Revenue Code of 1986.

5           (b) PURPOSE.—The purpose of this Act is to elimi-  
6           nate abusive tax shelters by denying tax attributes claimed  
7           to arise from transactions that do not meet a heightened  
8           economic substance requirement and by repealing the pro-  
9           vision that permits legal opinions to be used to avoid pen-  
10          alties on tax underpayments resulting from transactions  
11          without significant economic substance or business pur-  
12          pose.

13       **TITLE I—PROVISIONS DESIGNED**  
14       **TO CURTAIL TAX SHELTERS**

15       **SEC. 101. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**  
16       **TRINE.**

17          (a) IN GENERAL.—Section 7701 is amended by re-  
18          designating subsection (o) as subsection (p) and by insert-  
19          ing after subsection (n) the following new subsection:

20           “(o) CLARIFICATION OF ECONOMIC SUBSTANCE  
21          DOCTRINE; ETC.—

22           “(1) GENERAL RULES.—

23           “(A) IN GENERAL.—In applying the eco-  
24          nomic substance doctrine, the determination of

1           whether a transaction has economic substance  
2           shall be made as provided in this paragraph.

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

5                   “(i) IN GENERAL.—A transaction has  
6                   economic substance only if—

7                           “(I) the transaction changes in a  
8                           meaningful way (apart from Federal  
9                           tax effects and, if there are any Fed-  
10                           eral tax effects, also apart from any  
11                           foreign, State, or local tax effects) the  
12                           taxpayer’s economic position, and

13                           “(II) the taxpayer has a substan-  
14                           tial nontax purpose for entering into  
15                           such transaction and the transaction  
16                           is a reasonable means of accom-  
17                           plishing such purpose.

18                   “(ii) SPECIAL RULE WHERE TAX-  
19                   PAYER RELIES ON PROFIT POTENTIAL.—A  
20                   transaction shall not be treated as having  
21                   economic substance by reason of having a  
22                   potential for profit unless—

23                           “(I) the present value of the rea-  
24                           sonably expected pre-tax profit from  
25                           the transaction is substantial in rela-

1                   tion to the present value of the ex-  
2                   pected net tax benefits that would be  
3                   allowed if the transaction were re-  
4                   spected, and

5                   “(II) the reasonably expected  
6                   pre-tax profit from the transaction ex-  
7                   ceeds a risk-free rate of return.

8                   “(C) TREATMENT OF FEES AND FOREIGN  
9                   TAXES.—Fees and other transaction expenses  
10                  and foreign taxes shall be taken into account as  
11                  expenses in determining pre-tax profit under  
12                  subparagraph (B)(ii).

13                  “(2) SPECIAL RULES FOR TRANSACTIONS WITH  
14                  TAX-INDIFFERENT PARTIES.—

15                  “(A) SPECIAL RULES FOR FINANCING  
16                  TRANSACTIONS.—The form of a transaction  
17                  which is in substance the borrowing of money  
18                  or the acquisition of financial capital directly or  
19                  indirectly from a tax-indifferent party shall not  
20                  be respected if the present value of the deduc-  
21                  tions to be claimed with respect to the trans-  
22                  action is substantially in excess of the present  
23                  value of the anticipated economic returns of the  
24                  person lending the money or providing the fi-  
25                  nancial capital. A public offering shall be treat-

1 ed as a borrowing, or an acquisition of financial  
2 capital, from a tax-indifferent party if it is rea-  
3 sonably expected that at least 50 percent of the  
4 offering will be placed with tax-indifferent par-  
5 ties.

6 “(B) ARTIFICIAL INCOME SHIFTING AND  
7 BASIS ADJUSTMENTS.—The form of a trans-  
8 action with a tax-indifferent party shall not be  
9 respected if—

10 “(i) it results in an allocation of in-  
11 come or gain to the tax-indifferent party in  
12 excess of such party’s economic income or  
13 gain, or

14 “(ii) it results in a basis adjustment  
15 or shifting of basis on account of over-  
16 stating the income or gain of the tax-indif-  
17 ferent party.

18 “(3) DEFINITIONS AND SPECIAL RULES.—For  
19 purposes of this subsection—

20 “(A) ECONOMIC SUBSTANCE DOCTRINE.—  
21 The term ‘economic substance doctrine’ means  
22 the common law doctrine under which tax bene-  
23 fits under subtitle A with respect to a trans-  
24 action are not allowable if the transaction does

1 not have economic substance or lacks a business  
2 purpose.

3 “(B) TAX-INDIFFERENT PARTY.—The  
4 term ‘tax-indifferent party’ means any person  
5 or entity not subject to tax imposed by subtitle  
6 A. A person shall be treated as a tax-indifferent  
7 party with respect to a transaction if the items  
8 taken into account with respect to the trans-  
9 action have no substantial impact on such per-  
10 son’s liability under subtitle A.

11 “(C) SUBSTANTIAL NONTAX PURPOSE.—In  
12 applying subclause (II) of paragraph (1)(B)(i),  
13 a purpose of achieving a financial accounting  
14 benefit shall not be taken into account in deter-  
15 mining whether a transaction has a substantial  
16 nontax purpose if the origin of such financial  
17 accounting benefit is a reduction of income tax.

18 “(D) EXCEPTION FOR PERSONAL TRANS-  
19 ACTIONS OF INDIVIDUALS.—In the case of an  
20 individual, this subsection shall apply only to  
21 transactions entered into in connection with a  
22 trade or business or an activity engaged in for  
23 the production of income.

24 “(E) TREATMENT OF LESSORS.—In apply-  
25 ing subclause (I) of paragraph (1)(B)(ii) to the

1 lessor of tangible property subject to a lease,  
2 the expected net tax benefits shall not include  
3 the benefits of depreciation, or any tax credit,  
4 with respect to the leased property and sub-  
5 clause (II) of paragraph (1)(B)(ii) shall be dis-  
6 regarded in determining whether any of such  
7 benefits are allowable.

8 “(4) OTHER COMMON LAW DOCTRINES NOT AF-  
9 FECTED.—Except as specifically provided in this  
10 subsection, the provisions of this subsection shall not  
11 be construed as altering or supplanting any other  
12 rule of law, and the requirements of this subsection  
13 shall be construed as being in addition to any such  
14 other rule of law.

15 “(5) REGULATIONS.—The Secretary shall pre-  
16 scribe such regulations as may be necessary or ap-  
17 propriate to carry out the purposes of this sub-  
18 section. Such regulations may include exemptions  
19 from the application of this subsection.”.

20 (b) EFFECTIVE DATE.—The amendments made by  
21 this section shall apply to transactions entered into after  
22 February 13, 2003.

1 **SEC. 102. MODIFICATION OF PENALTY FOR FAILING TO DIS-**  
2 **CLOSE REPORTABLE TRANSACTION.**

3 (a) INCREASE IN PENALTY FOR LARGE ENTITIES  
4 AND HIGH NET WORTH INDIVIDUALS.—

5 (1) IN GENERAL.—Subsection (b) of section  
6 6707A is amended to read as follows:

7 “(b) AMOUNT OF PENALTY.—

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

11 “(A) \$10,000 in the case of a natural per-  
12 son who is not a high net worth individual,

13 “(B) \$100,000 in the case of a large entity  
14 or a high net worth individual, and

15 “(C) \$50,000 in any other case.

16 “(2) LISTED TRANSACTION.—The amount of  
17 the penalty under subsection (a) with respect to a  
18 listed transaction shall be—

19 “(A) \$100,000 in the case of a natural  
20 person who is not a high net worth individual,  
21 and

22 “(B) \$200,000 in any other case.”.

23 (2) LARGE ENTITIES AND HIGH NET WORTH IN-  
24 DIVIDUALS DEFINED.—Subsection (c) of section  
25 6707A is amended by adding at the end the fol-  
26 lowing new paragraphs:

1           “(1) LARGE ENTITY.—The term ‘large entity’  
2 means, with respect to any taxable year, a person  
3 (other than a natural person) with gross receipts in  
4 excess of \$10,000,000 for the taxable year in which  
5 the reportable transaction occurs or the preceding  
6 taxable year. Rules similar to the rules of paragraph  
7 (2) and subparagraphs (B), (C), and (D) of para-  
8 graph (3) of section 448(c) shall apply for purposes  
9 of this subparagraph.

10           “(2) HIGH NET WORTH INDIVIDUAL.—The  
11 term ‘high net worth individual’ means, with respect  
12 to a reportable transaction, a natural person whose  
13 net worth exceeds \$2,000,000 immediately before  
14 the transaction.”.

15           (b) RESTRICTION OF AUTHORITY TO RESCIND PEN-  
16 ALTY.—Paragraph (1) of section 6707A(d) is amended by  
17 striking “and” at the end of subparagraph (A), by redesignig-  
18 nating subparagraph (B) as subparagraph (E), and by in-  
19 serting after subparagraph (A) the following new subpara-  
20 graphs:

21                   “(B) the person on whom the penalty is  
22 imposed has a history of complying with the re-  
23 quirements of this title,

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

1           “(D) imposing the penalty would be  
2           against equity and good conscience, and”.

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

7 **SEC. 103. PENALTY FOR UNDERSTATEMENTS ATTRIB-**  
8                   **UTABLE TO TRANSACTIONS LACKING ECO-**  
9                   **NOMIC SUBSTANCE, ETC.**

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

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

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

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

1 ing the tax treatment of the item are adequately disclosed  
2 in the return or a statement attached to the return.

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

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

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

16 “(A) there is a lack of economic substance  
17 (within the meaning of section 7701(m)(1)) for  
18 the transaction giving rise to the claimed tax  
19 benefit or the transaction was not respected  
20 under section 7701(m)(2), or

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

23 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-  
24 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 (3), (4), and (5) of section 6707A(d) shall  
10          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.—

16                 “(1) For coordination of penalty with under-  
17                 statements under section 6662 and other special  
18                 rules, see section 6662A(e).

19                 “(2) For reporting of penalty imposed under  
20                 this section to the Securities and Exchange Commis-  
21                 sion, see section 6707A(e).”.

22          (b) COORDINATION WITH OTHER UNDERSTATE-  
23          MENTS AND PENALTIES.—

24                 (1) Subparagraph (A) of section 6662(d)(2) is  
25                 amended by inserting “and without regard to items

1 with respect to which a penalty is imposed by section  
2 6662B” before the period at the end.

3 (2) Subsection (e) of section 6662A is amend-  
4 ed—

5 (A) in paragraph (1), by inserting “and  
6 noneconomic substance transaction understatement”  
7 after “reportable transaction under-  
8 statements” each place it appears,

9 (B) in paragraph (2)(A) and (3), by insert-  
10 ing “and noneconomic substance transaction  
11 understatement” after “reportable transaction  
12 understatement”,

13 (C) in paragraph (2)(B), by inserting  
14 “6662B or” before “6663”,

15 (D) in paragraph (2)(C)(i), by inserting  
16 “or section 6662B” before the period at the  
17 end, and

18 (E) in paragraph (2)(C)(ii), by inserting  
19 “and section 6662B” after “This section”, and

20 (F) by adding at the end the following new  
21 paragraph:

22 “(4) NONECONOMIC SUBSTANCE TRANSACTION  
23 UNDERSTATEMENT.—For purposes of this sub-  
24 section, the term ‘noneconomic substance trans-

1       action understatement’ has the meaning given such  
2       term by section 6662B(c). ”.

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

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

7       (d) EFFECTIVE DATE.—The amendments made by  
8       this section shall apply to transactions entered into after  
9       February 13, 2003. Sections 6662(d)(2)(A) and 6662A(e)  
10      of the Internal Revenue Code of 1986 shall apply to such  
11      transactions to the extent such sections relate to such  
12      amendments.

13   **SEC. 104. REQUIRED DISCLOSURE BY MATERIAL ADVISORS**  
14                   **NOT SUBJECT TO CLAIM OF CONFIDEN-**  
15                   **TIALITY.**

16      (a) IN GENERAL.—Paragraph (1) of section 6112(b)  
17      is amended by adding at the end the following new flush  
18      sentence:

19           “For purposes of this section, the identity of any  
20           person on such list shall not be privileged.”.

21      (b) EFFECTIVE DATE.—The amendment made by  
22      this section shall take effect as if included in the amend-  
23      ments made by section 142 of the Deficit Reduction Act  
24      of 1984.

1 **SEC. 105. UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY**  
2 **INCOME TAX RETURN PREPARER.**

3 (a) STANDARDS CONFORMED TO TAXPAYER STAND-  
4 ARDS.—Section 6694(a) (relating to understatements due  
5 to unrealistic positions) is amended—

6 (1) by striking “realistic possibility of being  
7 sustained on its merits” in paragraph (1) and in-  
8 serting “reasonable belief that the tax treatment in  
9 such position was more likely than not the proper  
10 treatment”,

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

14 (3) by striking “Unrealistic” in the heading and  
15 inserting “Improper”.

16 (b) AMOUNT OF PENALTY.—Section 6694 is amend-  
17 ed—

18 (1) by striking “\$250” in subsection (a) and in-  
19 serting “\$1,000”, and

20 (2) by striking “\$1,000” in subsection (b) and  
21 inserting “\$5,000”.

22 (c) EFFECTIVE DATE.—The amendments made by  
23 this section shall apply to documents prepared after the  
24 date of the enactment of this Act.

1 **SEC. 106. FRIVOLOUS TAX SUBMISSIONS.**

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

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

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

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

9 “(A) does not contain information on  
10 which the substantial correctness of the self-as-  
11 sessment may be judged, or

12 “(B) contains information that on its face  
13 indicates that the self-assessment is substan-  
14 tially incorrect; and

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

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

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

21 “(b) CIVIL PENALTY FOR SPECIFIED FRIVOLOUS  
22 SUBMISSIONS.—

23 “(1) IMPOSITION OF PENALTY.—Except as pro-  
24 vided in paragraph (3), any person who submits a  
25 specified frivolous submission shall pay a penalty of  
26 \$5,000.

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

3           “(A) SPECIFIED FRIVOLOUS SUBMIS-  
4 SION.—The term ‘specified frivolous submis-  
5 sion’ means a specified submission if any por-  
6 tion of such submission—

7           “(i) is based on a position which the  
8 Secretary has identified as frivolous under  
9 subsection (c), or

10           “(ii) reflects a desire to delay or im-  
11 pede the administration of Federal tax  
12 laws.

13           “(B) SPECIFIED SUBMISSION.—The term  
14 ‘specified submission’ means—

15           “(i) a request for a hearing under—

16           “(I) section 6320 (relating to no-  
17 tice and opportunity for hearing upon  
18 filing of notice of lien), or

19           “(II) section 6330 (relating to  
20 notice and opportunity for hearing be-  
21 fore levy), and

22           “(ii) an application under—

23           “(I) section 6159 (relating to  
24 agreements for payment of tax liabil-  
25 ity in installments),

1                           “(II) section 7122 (relating to  
2                           compromises), or

3                           “(III) section 7811 (relating to  
4                           taxpayer assistance orders).

5                   “(3) OPPORTUNITY TO WITHDRAW SUBMIS-  
6                   SION.—If the Secretary provides a person with no-  
7                   tice that a submission is a specified frivolous sub-  
8                   mission and such person withdraws such submission  
9                   within 30 days after such notice, the penalty im-  
10                  posed under paragraph (1) shall not apply with re-  
11                  spect to such submission.

12                  “(c) LISTING OF FRIVOLOUS POSITIONS.—The Sec-  
13                  retary shall prescribe (and periodically revise) a list of po-  
14                  sitions which the Secretary has identified as being frivo-  
15                  lous for purposes of this subsection. The Secretary shall  
16                  not include in such list any position that the Secretary  
17                  determines meets the requirement of section  
18                  6662(d)(2)(B)(ii)(II).

19                  “(d) REDUCTION OF PENALTY.—The Secretary may  
20                  reduce the amount of any penalty imposed under this sec-  
21                  tion if the Secretary determines that such reduction would  
22                  promote compliance with and administration of the Fed-  
23                  eral tax laws.

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

4       (b) TREATMENT OF FRIVOLOUS REQUESTS FOR  
5 HEARINGS BEFORE LEVY.—

6           (1) FRIVOLOUS REQUESTS DISREGARDED.—

7       Section 6330 (relating to notice and opportunity for  
8 hearing before levy) is amended by adding at the  
9 end the following new subsection:

10       “(g) FRIVOLOUS REQUESTS FOR HEARING, ETC.—

11 Notwithstanding any other provision of this section, if the  
12 Secretary determines that any portion of a request for a  
13 hearing under this section or section 6320 meets the re-  
14 quirement of clause (i) or (ii) of section 6702(b)(2)(A),  
15 then the Secretary may treat such portion as if it were  
16 never submitted and such portion shall not be subject to  
17 any further administrative or judicial review.”.

18           (2) PRECLUSION FROM RAISING FRIVOLOUS

19 ISSUES AT HEARING.—Section 6330(c)(4) is amend-  
20 ed—

21           (A) by striking “(A)” and inserting

22           “(A)(i)”;

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

24           (C) by striking the period at the end of the

25           first sentence and inserting “; or”; and

1 (D) by inserting after subparagraph (A)(ii)  
2 (as so redesignated) the following:

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

5 (3) STATEMENT OF GROUNDS.—Section  
6 6330(b)(1) is amended by striking “under sub-  
7 section (a)(3)(B)” and inserting “in writing under  
8 subsection (a)(3)(B) and states the grounds for the  
9 requested hearing”.

10 (c) TREATMENT OF FRIVOLOUS REQUESTS FOR  
11 HEARINGS UPON FILING OF NOTICE OF LIEN.—Section  
12 6320 is amended—

13 (1) in subsection (b)(1), by striking “under sub-  
14 section (a)(3)(B)” and inserting “in writing under  
15 subsection (a)(3)(B) and states the grounds for the  
16 requested hearing”, and

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

19 (d) TREATMENT OF FRIVOLOUS APPLICATIONS FOR  
20 OFFERS-IN-COMPROMISE AND INSTALLMENT AGREE-  
21 MENTS.—Section 7122 is amended by adding at the end  
22 the following new subsection:

23 “(e) FRIVOLOUS SUBMISSIONS, ETC.—Notwith-  
24 standing any other provision of this section, if the Sec-  
25 retary determines that any portion of an application for

1 an offer-in-compromise or installment agreement sub-  
 2 mitted under this section or section 6159 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 (e) CLERICAL AMENDMENT.—The table of sections  
 8 for part I of subchapter B of chapter 68 is amended by  
 9 striking the item relating to section 6702 and inserting  
 10 the following new item:

“Sec. 6702. Frivolous tax submissions.”

11 (f) EFFECTIVE DATE.—The amendments made by  
 12 this section shall apply to submissions made and issues  
 13 raised after the date on which the Secretary first pre-  
 14 scribes a list under section 6702(e) of the Internal Rev-  
 15 enue Code of 1986, as amended by subsection (a).

16 **SEC. 107. DENIAL OF DEDUCTION FOR INTEREST ON UN-**  
 17 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**  
 18 **CLOSED REPORTABLE AND NONECONOMIC**  
 19 **SUBSTANCE TRANSACTIONS.**

20 (a) IN GENERAL.—Subsection (m) of section 163 is  
 21 amended to read as follows:

22 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE  
 23 TO NONDISCLOSED REPORTABLE TRANSACTIONS AND  
 24 NONECONOMIC SUBSTANCE TRANSACTIONS.—No deduc-  
 25 tion shall be allowed under this chapter for any interest

1 paid or accrued under section 6601 on any underpayment  
2 of tax which is attributable to—

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

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

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

## 13 **TITLE II—OTHER PROVISIONS**

### 14 **SEC. 201. EXPANDED AUTHORITY TO DISALLOW TAX BENE-** 15 **FITS UNDER SECTION 269.**

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

19 “(a) IN GENERAL.—If—

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

22 “(B) any corporation acquires, directly or indi-  
23 rectly, property of another corporation and the basis  
24 of such property, in the hands of the acquiring cor-

1       poration, is determined by reference to the basis in  
2       the hands of the transferor corporation, and

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

7 then the Secretary may disallow such deduction, credit,  
8 or other allowance.”.

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

12 **SEC. 202. MODIFICATIONS OF CERTAIN RULES RELATING**  
13 **TO CONTROLLED FOREIGN CORPORATIONS.**

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

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

24       (b) DETERMINATION OF PRO RATA SHARE OF SUB-  
25 PART F INCOME.—Subsection (a) of section 951 (relating

1 to amounts included in gross income of United States  
2 shareholders) is amended by adding at the end the fol-  
3 lowing new paragraph:

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

8                   “(A) any rights lacking substantial eco-  
9 nomic effect, and

10                   “(B) stock owned by a shareholder who is  
11 a tax-indifferent party (as defined in section  
12 7701(m)(3)) if the amount which would (but  
13 for this paragraph) be allocated to such share-  
14 holder does not reflect such shareholder’s eco-  
15 nomic share of the earnings and profits of the  
16 corporation.”.

17           (c) EFFECTIVE DATE.—The amendments made by  
18 this section shall apply to taxable years on controlled for-  
19 eign corporation beginning after February 13, 2003, and  
20 to taxable years of United States shareholder in which or  
21 with which such taxable years of controlled foreign cor-  
22 porations end.

1 **SEC. 203. BASIS FOR DETERMINING LOSS ALWAYS RE-**  
2 **DUCED BY NONTAXED PORTION OF DIVI-**  
3 **DENDS.**

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

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

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

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