

**AMENDMENT IN THE NATURE OF A SUBSTITUTE
TO H.R. 2896
OFFERED BY MR. THOMAS**

Strike all after the enacting clause and insert the following:

1 SECTION 1. SHORT TITLE; ETC.

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

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

10 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; etc.

TITLE I—CORPORATE REFORM AND GROWTH INCENTIVES

Subtitle A—Reduction in Corporate Income Tax Rates

Sec. 1001. Reduced corporate income tax rate for domestic production activities income.

Sec. 1002. Reduced corporate income tax rate for small corporations.

Subtitle B—Small Business Expensing

Sec. 1011. 2-year extension of increased expensing for small business.

Subtitle C—Depreciation

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

Subtitle D—Alternative Minimum Tax Relief



- Sec. 1031. Net operating losses and foreign tax credit under alternative minimum tax.
- Sec. 1032. Expansion of exemption from alternative minimum tax for small corporations.
- Sec. 1033. Income averaging for farmers not to increase alternative minimum tax.

Subtitle E—S Corporation Reform and Simplification

- Sec. 1041. Members of family treated as 1 shareholder.
- Sec. 1042. Increase in number of eligible shareholders to 100.
- Sec. 1043. Expansion of bank S corporation eligible shareholders to include IRAs.
- Sec. 1044. Disregard of unexercised powers of appointment in determining potential current beneficiaries of ESBT.
- Sec. 1045. Transfer of suspended losses incident to divorce, etc.
- Sec. 1046. Use of passive activity loss and at-risk amounts by qualified subchapter S trust income beneficiaries.
- Sec. 1047. Exclusion of investment securities income from passive income test for bank S corporations.
- Sec. 1048. Treatment of bank director shares.
- Sec. 1049. Relief from inadvertently invalid qualified subchapter S subsidiary elections and terminations.
- Sec. 1050. Information returns for qualified subchapter S subsidiaries.
- Sec. 1051. Repayment of loans for qualifying employer securities.

Subtitle F—Protecting Employee Benefits

- Sec. 1061. Treatment of nonqualified deferred compensation plans.
- Sec. 1062. Exclusion of incentive stock options and employee stock purchase plan stock options from wages.
- Sec. 1063. Extension of transfers of excess pension assets to retiree health accounts.

Subtitle G—Treatment of Active Income

- Sec. 1071. Member states of the European Union treated as a single country for certain purposes
- Sec. 1072. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company income rules.
- Sec. 1073. Look-thru treatment for sales of partnership interests.
- Sec. 1074. Repeal of foreign personal holding company rules and foreign investment company rules.
- Sec. 1075. Clarification of treatment of pipeline transportation income.
- Sec. 1076. Determination of foreign personal holding company income with respect to transactions in commodities.
- Sec. 1077. Repeal of CFC rules on foreign base company shipping income.
- Sec. 1078. Modification of subpart F exemption for active financing.
- Sec. 1079. Partial exclusion for income attributable to films used outside the United States.

Subtitle H—Reduction of Double Taxation of Earnings

- Sec. 1081. Interest expense allocation rules.
- Sec. 1082. Recharacterization of overall domestic loss.
- Sec. 1083. Reduction to 2 foreign tax credit baskets.



- Sec. 1084. Look-thru rules to apply to dividends from noncontrolled section 902 corporations.
- Sec. 1085. Attribution of stock ownership through partnerships to apply in determining section 902 and 960 credits.
- Sec. 1086. Clarification of treatment of certain transfers of intangible property.
- Sec. 1087. United States property not to include certain assets acquired by dealers in ordinary course of trade or business.
- Sec. 1088. Election not to use average exchange rate for foreign tax paid other than in functional currency.
- Sec. 1089. Repeal of withholding tax on dividends from certain foreign corporations.
- Sec. 1090. Provide equal treatment for interest paid by foreign partnerships and foreign corporations.

Subtitle I—Other Provisions

- Sec. 1101. Special rules for livestock sold on account of weather-related conditions.
- Sec. 1102. Payment of dividends on stock of cooperatives without reducing patronage dividends.
- Sec. 1103. Vaccine tax to apply to Hepatitis A vaccine.
- Sec. 1104. Expansion of human clinical trials qualifying for orphan drug credit.
- Sec. 1105. Treatment of distributions from publicly traded partnerships to regulated investment companies.
- Sec. 1106. Improvements related to real estate investment trusts.
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- Sec. 1109. Income tax credit to distilled spirits wholesalers for cost of carrying Federal excise taxes on bottled distilled spirits.
- Sec. 1110. Capital gain treatment under section 631(b) to apply to outright sales by landowners.
- Sec. 1111. Sonar devices suitable for finding fish.
- Sec. 1112. Taxation of certain settlement funds.
- Sec. 1113. Suspension of occupational taxes relating to distilled spirits, wine, and beer.

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

- Sec. 2001. Reduction in potential for earnings stripping by further limiting deduction for interest on certain indebtedness.
- Sec. 2002. Tax treatment of expatriated entities and their foreign parents.
- Sec. 2003. Excise tax on stock compensation of insiders in expatriated corporations.
- Sec. 2004. Reinsurance of United States risks in foreign jurisdictions.
- Sec. 2005. Revision of tax rules on expatriation of individuals.
- Sec. 2006. Reporting of taxable mergers and acquisitions.
- Sec. 2007. Studies.

TITLE III—PROVISIONS RELATING TO TAX SHELTERS

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- Sec. 3001. Penalty for failing to disclose reportable transactions.
- Sec. 3002. Accuracy-related penalty for listed transactions, other reportable transactions having a significant tax avoidance purpose, etc.



- Sec. 3003. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
- Sec. 3004. Statute of limitations for taxable years for which required listed transactions not reported.
- Sec. 3005. Disclosure of reportable transactions.
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- Sec. 3007. Modification of penalty for failure to maintain lists of investors.
- Sec. 3008. Penalty on promoters of tax shelters.
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- Sec. 3010. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.
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- Sec. 3012. Regulation of individuals practicing before the Department of the Treasury.

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- Sec. 3025. Repeal of special rules for FASITS.
- Sec. 3026. Limitation on transfer of built-in losses on REMIC residuals.
- Sec. 3027. Clarification of banking business for purposes of determining investment of earnings in United States property.
- Sec. 3028. Modifications related to certain small insurance companies.
- Sec. 3029. Definition of insurance company for section 831.
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- Sec. 3031. Clarification of rules for payment of estimated tax for certain deemed asset sales.
- Sec. 3032. Recognition of gain from the sale of a principal residence acquired in a like-kind exchange within 5 years of sale.
- Sec. 3033. Prevention of mismatching of interest and original issue discount deductions and income inclusions in transactions with related foreign persons.
- Sec. 3034. Exclusion from gross income for interest on overpayments of income tax by individuals.
- Sec. 3035. Deposits made to suspend running of interest on potential underpayments.
- Sec. 3036. Partial payment of tax liability in installment agreements.
- Sec. 3037. Extension of IRS user fees.

TITLE IV—TRADE ENHANCEMENT AND COMPLIANCE PROVISIONS

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



1 **TITLE I—CORPORATE REFORM**
 2 **AND GROWTH INCENTIVES**
 3 **Subtitle A—Reduction in Corporate**
 4 **Income Tax Rates**

5 **SEC. 1001. REDUCED CORPORATE INCOME TAX RATE FOR**
 6 **DOMESTIC PRODUCTION ACTIVITIES IN-**
 7 **COME.**

8 (a) **LIMITATION ON TAX ON QUALIFIED PRODUCTION**
 9 **ACTIVITIES INCOME.**—Section 11 is amended by redesignig-
 10 nating subsections (c) and (d) as subsections (d) and (e),
 11 respectively, and by inserting after subsection (b) the fol-
 12 lowing new subsection:

13 “(c) **LIMITATION ON TAX ON QUALIFIED PRODUC-**
 14 **TION ACTIVITIES INCOME.**—

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

19 “(A) a tax computed at the rates and in
 20 the manner as if this subsection had not been
 21 enacted on the taxable income reduced by the
 22 amount of qualified production activities in-
 23 come, plus

24 “(B) a tax equal to 32 percent (34 percent
 25 in the case of taxable years beginning before



1 January 1, 2007) of the qualified production
2 activities income (or, if less, taxable income).

3 “(2) QUALIFIED PRODUCTION ACTIVITIES IN-
4 COME.—

5 “(A) IN GENERAL.—The term ‘qualified
6 production activities income’ for any taxable
7 year means an amount equal to the excess (if
8 any) of—

9 “(i) the taxpayer’s domestic produc-
10 tion gross receipts for such taxable year,
11 over

12 “(ii) the sum of—

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

15 “(II) other deductions, expenses,
16 or losses directly allocable to such re-
17 cepts, and

18 “(III) a ratable portion of other
19 deductions, expenses, and losses that
20 are not directly allocable to such re-
21 cepts or another class of income.

22 “(B) ALLOCATION METHOD.—The Sec-
23 retary shall prescribe rules for the proper allo-
24 cation of items of income, deduction, expense,



1 and loss for purposes of determining income at-
2 tributable to domestic production activities.

3 “(3) DOMESTIC PRODUCTION GROSS RE-
4 CEIPTS.—For purposes of this subsection, the term
5 ‘domestic production gross receipts’ means the gross
6 receipts of the taxpayer which are derived from—

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

9 “(i) qualifying production property
10 which was manufactured, produced, grown,
11 or extracted in whole or in significant part
12 by the taxpayer within the United States,
13 or

14 “(ii) any qualified film produced by
15 the taxpayer, or

16 “(B) construction services or engineering
17 or architectural services for construction
18 projects.

19 “(4) QUALIFYING PRODUCTION PROPERTY.—
20 For purposes of this subsection, the term ‘qualifying
21 production property’ means—

22 “(A) tangible personal property,

23 “(B) any computer software, and

24 “(C) any property described in section
25 168(f)(4).



1 “(5) QUALIFIED FILM.—For purposes of this
2 subsection—

3 “(A) IN GENERAL.—The term ‘qualified
4 film’ means any property described in section
5 168(f)(3) if not less than 50 percent of the
6 total compensation relating to the production of
7 such property is compensation for services per-
8 formed in the United States by actors, produc-
9 tion personnel, directors, and producers.

10 “(B) EXCEPTION.—Such term does not in-
11 clude property with respect to which records are
12 required to be maintained under section 2257
13 of title 18, United States Code.

14 “(6) RELATED PERSONS.—For purposes of this
15 subsection—

16 “(A) IN GENERAL.— The term ‘domestic
17 production gross receipts’ shall not include any
18 gross receipts of the taxpayer derived from a
19 lease, rental, or license with any person related
20 to the taxpayer.

21 “(B) RELATED PERSON.—For purposes of
22 subparagraph (A), a person shall be treated as
23 related to another person if such persons are
24 treated as a single employer under subsection
25 (a) or (b) of section 52 or subsection (m) or (o)



1 of section 414, except that determinations
 2 under subsections (a) and (b) of section 52
 3 shall be made without regard to section
 4 1563(b).”.

5 (b) EFFECTIVE DATE.—The amendment made by
 6 this section shall apply to taxable years beginning after
 7 December 31, 2003.

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

10 (a) IN GENERAL.—Subsection (b) of section 11 (re-
 11 lating to tax imposed on corporations) is amended by re-
 12 designating paragraph (2) as paragraph (6) and by strik-
 13 ing paragraph (1) and inserting the following new para-
 14 graphs:

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

20

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



1 “(2) FOR TAXABLE YEARS BEGINNING IN 2009,
 2 2010, OR 2011.—In the case of taxable years begin-
 3 ning in 2009, 2010, or 2011, the amount of the tax
 4 imposed by subsection (a) shall be determined in ac-
 5 cordance with the following table:

6

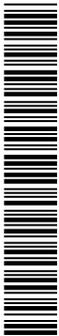
“If taxable income is:	The tax is:
Not over \$50,000	15% of taxable income.
Over \$50,000 but not over \$75,000.	\$7,500, plus 25% of the excess over \$50,000.
Over \$75,000 but not over \$5,000,000.	\$13,750, plus 32% of the excess over \$75,000.
Over \$5,000,000 but not over \$10,000,000.	\$1,589,750,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

7 “(3) FOR TAXABLE YEARS BEGINNING IN 2007
 8 OR 2008.—In the case of taxable years beginning in
 9 2007 or 2008, the amount of the tax imposed by
 10 subsection (a) shall be determined in accordance
 11 with the following table:

12

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

13 “(4) FOR TAXABLE YEARS BEGINNING IN 2004,
 14 2005, OR 2006.—In the case of taxable years begin-
 15 ning in 2004, 2005, or 2006, the amount of the tax



1 imposed by subsection (a) shall be determined in ac-
2 cordance with the following table:

3

“If taxable income is:	The tax is:
Not over \$50,000	15% of taxable income.
Over \$50,000 but not over \$75,000.	\$7,500, plus 25% of the excess over \$50,000.
Over \$75,000 but not over \$1,000,000.	\$13,750, plus 33% of the excess over \$75,000.
Over \$1,000,000 but not over \$10,000,000.	\$319,000, plus 34% of the excess over \$1,000,000.
Over \$10,000,000	\$3,379,000, plus 35% of the excess over \$10,000,000.

4 “(5) PHASEOUT OF LOWER RATES FOR CER-
5 TAIN TAXPAYERS.—

6 “(A) GENERAL RULE FOR YEARS BEFORE
7 2012.—

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

18 “(ii) MAXIMUM INCREASE AMOUNT.—
19 For purposes of clause (i)—



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

1 “(B) HIGHER INCOME CORPORATIONS.—In
2 the case of a corporation which has taxable in-
3 come in excess of \$20,000,000 (\$15,000,000 in
4 the case of taxable years beginning before
5 2012), the amount of the tax determined under
6 the foregoing provisions of this subsection shall
7 be increased by an additional amount equal to
8 the lesser of (i) 3 percent of such excess, or (ii)
9 \$610,250 (\$100,000 in the case of taxable
10 years beginning before 2012).”.

11 (b) CONFORMING AMENDMENTS.—

12 (1) Section 904(b)(3)(D)(ii) is amended to read
13 as follows:

14 “(ii) in the case of a corporation, sec-
15 tion 1201(a) applies to such taxable
16 year.”.

17 (2) Section 1201(a) is amended by striking
18 “the last 2 sentences of section 11(b)(1)” and in-
19 serting “section 11(b)(5)”.

20 (3) Section 1561(a) is amended—



1 (A) by striking “the last 2 sentences of
2 section 11(b)(1)” and inserting “section
3 11(b)(5)”, and

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

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 2003.

9 **Subtitle B—Small Business** 10 **Expensing**

11 **SEC. 1011. 2-YEAR EXTENSION OF INCREASED EXPENSING** 12 **FOR SMALL BUSINESS.**

13 Subsections (b), (c), and (d) of section 179 (as
14 amended by the Jobs and Growth Tax Relief Reconcili-
15 ation Act of 2003) are each amended by striking “2006”
16 each place it appears and inserting “2008”.

17 **Subtitle C—Depreciation**

18 **SEC. 1021. RECOVERY PERIOD FOR DEPRECIATION OF CER-** 19 **TAIN LEASEHOLD IMPROVEMENTS AND RES-** 20 **TAURANT PROPERTY.**

21 (a) 15-YEAR RECOVERY PERIOD.—Subparagraph
22 (E) of section 168(e)(3) (relating to classification of cer-
23 tain property) is amended by striking “and” at the end
24 of clause (ii), by striking the period at the end of clause
25 (iii), and by adding at the end the following new clauses:



1 “(iv) any qualified leasehold improve-
 2 ment property placed in service before Jan-
 3 uary 1, 2006, and

4 “(v) any qualified restaurant property
 5 placed in service before January 1, 2006.

6 (b) QUALIFIED LEASEHOLD IMPROVEMENT PROP-
 7 ERTY.—Subsection (e) of section 168 is amended by add-
 8 ing at the end the following new paragraph:

9 “(6) QUALIFIED LEASEHOLD IMPROVEMENT
 10 PROPERTY.—The term ‘qualified leasehold improve-
 11 ment property’ has the meaning given such term in
 12 section 168(k)(3) except that the following special
 13 rules shall apply:

14 “(A) IMPROVEMENTS MADE BY LESSOR.—
 15 In the case of an improvement made by the per-
 16 son who was the lessor of such improvement
 17 when such improvement was placed in service,
 18 such improvement shall be qualified leasehold
 19 improvement property (if at all) only so long as
 20 such improvement is held by such person.

21 “(B) EXCEPTION FOR CHANGES IN FORM
 22 OF BUSINESS.—Property shall not cease to be
 23 qualified leasehold improvement property under
 24 subparagraph (A) by reason of—

25 “(i) death,



1 “(ii) a transaction to which section
2 381(a) applies,

3 “(iii) a mere change in the form of
4 conducting the trade or business so long as
5 the property is retained in such trade or
6 business as qualified leasehold improve-
7 ment property and the taxpayer retains a
8 substantial interest in such trade or busi-
9 ness,

10 “(iv) the acquisition of such property
11 in an exchange described in section 1031,
12 1033, 1038, or 1039 to the extent that the
13 basis of such property includes an amount
14 representing the adjusted basis of other
15 property owned by the taxpayer or a re-
16 lated person, or

17 “(v) the acquisition of such property
18 by the taxpayer in a transaction described
19 in section 332, 351, 361, 721, or 731 (or
20 the acquisition of such property by the tax-
21 payer from the transferee or acquiring cor-
22 poration in a transaction described in such
23 section), to the extent that the basis of the
24 property in the hands of the taxpayer is



1 determined by reference to its basis in the
2 hands of the transferor or distributor.”.

3 (c) QUALIFIED RESTAURANT PROPERTY.—Sub-
4 section (e) of section 168 (as amended by subsection (b))
5 is further amended by adding at the end the following new
6 paragraph:

7 “(7) QUALIFIED RESTAURANT PROPERTY.—The
8 term ‘qualified restaurant property’ means any sec-
9 tion 1250 property which is an improvement to a
10 building if—

11 “(A) such improvement is placed in service
12 more than 3 years after the date such building
13 was first placed in service, and

14 “(B) more than 50 percent of the build-
15 ing’s square footage is devoted to preparation
16 of, and seating for on-premises consumption of,
17 prepared meals.”.

18 (d) REQUIREMENT TO USE STRAIGHT LINE METH-
19 OD.—

20 (1) Paragraph (3) of section 168(b) is amended
21 by adding at the end the following new subpara-
22 graphs:

23 “(G) Qualified leasehold improvement
24 property described in subsection (e)(6).



1 “(H) Qualified restaurant property de-
2 scribed in subsection (e)(7).”.

3 (2) Subparagraph (A) of section 168(b)(2) is
4 amended by inserting before the comma “not re-
5 ferred to in paragraph (3)”.

6 (e) ALTERNATIVE SYSTEM.—The table contained in
7 section 168(g)(3)(B) is amended by adding at the end the
8 following new items:

“(E)(iv)	39
“(E)(v)	39”.

9 (f) EFFECTIVE DATE.—The amendments made by
10 this section shall apply to property placed in service after
11 the date of the enactment of this Act.

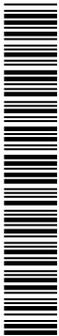
12 **Subtitle D—Alternative Minimum**
13 **Tax Relief**

14 **SEC. 1031. NET OPERATING LOSSES AND FOREIGN TAX**
15 **CREDIT UNDER ALTERNATIVE MINIMUM TAX.**

16 (a) NET OPERATING LOSSES.—

17 (1) IN GENERAL.—Subparagraph (A) of section
18 56(d)(1) is amended to read as follows:

19 “(A) the amount of such deduction shall
20 not exceed the applicable percentage (deter-
21 mined under paragraph (3)) of the alternative
22 minimum taxable income determined without
23 regard to such deduction, and”.



1 (2) APPLICABLE PERCENTAGE.—Subsection (d)
 2 of section 56 is amended by adding at the end the
 3 following new paragraph:

4 “(3) APPLICABLE PERCENTAGE.—For purposes
 5 of paragraph (1)(A)—

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

6 (b) FOREIGN TAX CREDIT.—

7 (1) Subsection (a) of section 59 is amended by
 8 striking paragraph (2) and by redesignating para-
 9 graphs (3) and (4) as paragraphs (2) and (3), re-
 10 spectively.

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

13 (c) EFFECTIVE DATE.—The amendments made by
 14 this section shall apply to taxable years beginning after
 15 December 31, 2004.

16 **SEC. 1032. EXPANSION OF EXEMPTION FROM ALTERNATIVE**
 17 **MINIMUM TAX FOR SMALL CORPORATIONS.**

18 (a) IN GENERAL.—Subparagraphs (A) and (B) of
 19 section 55(e)(1) are each amended by striking
 20 “\$7,500,000” each place it appears and inserting
 21 “\$20,000,000”.



1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to taxable years beginning after
3 December 31, 2004.

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

6 (a) IN GENERAL.—Subsection (c) of section 55 (de-
7 fining regular tax) is amended by redesignating paragraph
8 (2) as paragraph (3) and by inserting after paragraph (1)
9 the following new paragraph:

10 “(2) COORDINATION WITH INCOME AVERAGING
11 FOR FARMERS.—Solely for purposes of this section,
12 section 1301 (relating to averaging of farm income)
13 shall not apply in computing the regular tax liabil-
14 ity.”.

15 (b) EFFECTIVE DATE.—The amendment made by
16 subsection (a) shall apply to taxable years beginning after
17 December 31, 2002.

18 **Subtitle E—S Corporation Reform**
19 **and Simplification**

20 **SEC. 1041. MEMBERS OF FAMILY TREATED AS 1 SHARE-**
21 **HOLDER.**

22 (a) IN GENERAL.—Paragraph (1) of section 1361(c)
23 (relating to special rules for applying subsection (b)) is
24 amended to read as follows:



1 “(1) MEMBERS OF FAMILY TREATED AS 1
2 SHAREHOLDER.—

3 “(A) IN GENERAL.—For purpose of sub-
4 section (b)(1)(A)—

5 “(i) except as provided in clause (ii),
6 a husband and wife (and their estates)
7 shall be treated as 1 shareholder, and

8 “(ii) in the case of a family with re-
9 spect to which an election is in effect
10 under subparagraph (D), all members of
11 the family shall be treated as 1 share-
12 holder.

13 “(B) MEMBERS OF THE FAMILY.—For
14 purpose of subparagraph (A)(ii)—

15 “(i) IN GENERAL.—The term ‘mem-
16 bers of the family’ means the common an-
17 cestor, lineal descendants of the common
18 ancestor, and the spouses (or former
19 spouses) of such lineal descendants or com-
20 mon ancestor.

21 “(ii) COMMON ANCESTOR.—For pur-
22 poses of this paragraph, an individual shall
23 not be considered a common ancestor if, as
24 of the later of the effective date of this
25 paragraph or the time the election under



1 section 1362(a) is made, the individual is
2 more than 3 generations removed from the
3 youngest generation of shareholders who
4 would (but for this clause) be members of
5 the family. For purposes of the preceding
6 sentence, a spouse (or former spouse) shall
7 be treated as being of the same generation
8 as the individual to which such spouse is
9 (or was) married.

10 “(C) EFFECT OF ADOPTION, ETC.—In de-
11 termining whether any relationship specified in
12 subparagraph (B) exists, the rules of section
13 152(b)(2) shall apply.

14 “(D) ELECTION.—An election under sub-
15 paragraph (A)(ii)—

16 “(i) may, except as otherwise provided
17 in regulations prescribed by the Secretary,
18 be made by any member of the family, and

19 “(ii) shall remain in effect until termi-
20 nated as provided in regulations prescribed
21 by the Secretary.”

22 (b) RELIEF FROM INADVERTENT INVALID ELECTION
23 OR TERMINATION.—Section 1362(f) (relating to inad-
24 vertent invalid elections or terminations), as amended by
25 section 1049, is amended—



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

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

6 (c) EFFECTIVE DATES.—

7 (1) SUBSECTION (a).—The amendment made by
8 subsection (a) shall apply to taxable years beginning
9 after December 31, 2003.

10 (2) SUBSECTION (b).—The amendments made
11 by subsection (b) shall apply to elections and termi-
12 nations made after December 31, 2003.

13 **SEC. 1042. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
14 **HOLDERS TO 100.**

15 (a) IN GENERAL.—Section 1361(b)(1)(A) (defining
16 small business corporation) is amended by striking “75”
17 and inserting “100”.

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

21 **SEC. 1043. EXPANSION OF BANK S CORPORATION ELIGIBLE**
22 **SHAREHOLDERS TO INCLUDE IRAS.**

23 (a) IN GENERAL.—Section 1361(c)(2)(A) (relating to
24 certain trusts permitted as shareholders) is amended by
25 inserting after clause (v) the following new clause:



1 “(vi) In the case of a corporation
2 which is a bank (as defined in section
3 581), a trust which constitutes an indi-
4 vidual retirement account under section
5 408(a), including one designated as a Roth
6 IRA under section 408A, but only to the
7 extent of the stock held by such trust in
8 such bank as of the date of the enactment
9 of this clause.”.

10 (b) TREATMENT AS SHAREHOLDER.—Section
11 1361(c)(2)(B) (relating to treatment as shareholders) is
12 amended by adding at the end the following new clause:

13 “(vi) In the case of a trust described
14 in clause (vi) of subparagraph (A), the in-
15 dividual for whose benefit the trust was
16 created shall be treated as a shareholder.”.

17 (c) SALE OF BANK STOCK IN IRA RELATING TO S
18 CORPORATION ELECTION EXEMPT FROM PROHIBITED
19 TRANSACTION RULES.—Section 4975(d) (relating to ex-
20 emptions) is amended by striking “or” at the end of para-
21 graph (14), by striking the period at the end of paragraph
22 (15) and inserting “; or”, and by adding at the end the
23 following new paragraph:

24 “(16) a sale of stock held by a trust which con-
25 stitutes an individual retirement account under sec-



1 tion 408(a) to the individual for whose benefit such
2 account is established if—

3 “(A) such stock is in a bank (as defined in
4 section 581),

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

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

9 “(D) such sale is for fair market value at
10 the time of sale (as established by an inde-
11 pendent appraiser) and the terms of the sale
12 are otherwise at least as favorable to such trust
13 as the terms that would apply on a sale to an
14 unrelated party,

15 “(E) such trust does not pay any commis-
16 sions, costs, or other expenses in connection
17 with the sale, and

18 “(F) the stock is sold in a single trans-
19 action for cash not later than 120 days after
20 the S corporation election is made.”.

21 (d) CONFORMING AMENDMENT.—Section 512(e)(1)
22 is amended by inserting “1361(c)(2)(A)(vi) or” before
23 “1361(c)(6)”.



1 (e) EFFECTIVE DATE.—The amendments made by
2 this section shall take effect on the date of the enactment
3 of this Act.

4 **SEC. 1044. DISREGARD OF UNEXERCISED POWERS OF AP-**
5 **POINTMENT IN DETERMINING POTENTIAL**
6 **CURRENT BENEFICIARIES OF ESBT.**

7 (a) IN GENERAL.—Section 1361(e)(2) (defining po-
8 tential current beneficiary) is amended—

9 (1) by inserting “(determined without regard to
10 any power of appointment to the extent such power
11 remains unexercised at the end of such period)”
12 after “of the trust” in the first sentence, and

13 (2) by striking “60-day” in the second sentence
14 and inserting “1-year”.

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

18 **SEC. 1045. TRANSFER OF SUSPENDED LOSSES INCIDENT TO**
19 **DIVORCE, ETC.**

20 (a) IN GENERAL.—Section 1366(d)(2) (relating to
21 indefinite carryover of disallowed losses and deductions)
22 is amended to read as follows:

23 “(2) INDEFINITE CARRYOVER OF DISALLOWED
24 LOSSES AND DEDUCTIONS.—



1 (2) by striking the period at the end of sub-
2 paragraph (B) and inserting “, and”, and

3 (3) by adding at the end the following new sub-
4 paragraph:

5 “(C) for purposes of applying sections 465
6 and 469 to the beneficiary of the trust, the dis-
7 position of the S corporation stock by the trust
8 shall be treated as a disposition by such bene-
9 ficiary.”.

10 (b) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to transfers made after December
12 31, 2003.

13 **SEC. 1047. EXCLUSION OF INVESTMENT SECURITIES IN-**
14 **COME FROM PASSIVE INCOME TEST FOR**
15 **BANK S CORPORATIONS.**

16 (a) IN GENERAL.—Section 1362(d)(3) (relating to
17 where passive investment income exceeds 25 percent of
18 gross receipts for 3 consecutive taxable years and corpora-
19 tion has accumulated earnings and profits) is amended by
20 adding at the end the following new subparagraph:

21 “(F) EXCEPTION FOR BANKS; ETC.—In
22 the case of a bank (as defined in section 581),
23 a bank holding company (within the meaning of
24 section 2(a) of the Bank Holding Company Act
25 of 1956 (12 U.S.C. 1841(a))), or a financial



1 holding company (within the meaning of section
2 2(p) of such Act), the term ‘passive investment
3 income’ shall not include—

4 “(i) interest income earned by such
5 bank or company, or

6 “(ii) dividends on assets required to
7 be held by such bank or company, includ-
8 ing stock in the Federal Reserve Bank, the
9 Federal Home Loan Bank, or the Federal
10 Agricultural Mortgage Bank or participa-
11 tion certificates issued by a Federal Inter-
12 mediate Credit Bank.”.

13 (b) EFFECTIVE DATE.—The amendment made by
14 this section shall apply to taxable years beginning after
15 December 31, 2003.

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

17 (a) IN GENERAL.—Section 1361 (defining S corpora-
18 tion) is amended by adding at the end the following new
19 subsection:

20 “(f) RESTRICTED BANK DIRECTOR STOCK.—

21 “(1) IN GENERAL.—Restricted bank director
22 stock shall not be treated as stock of the S corpora-
23 tion in applying this subchapter (other than section
24 1368(f)).



1 “(2) RESTRICTED BANK DIRECTOR STOCK.—
2 For purposes of this subsection, the term ‘restricted
3 bank director stock’ means stock in a bank (as de-
4 fined in section 581), a bank holding company (with-
5 in the meaning of section 2(a) of the Bank Holding
6 Company Act of 1956 (12 U.S.C. 1841(a))), or a fi-
7 nancial holding company (within the meaning of sec-
8 tion 2(p) of such Act), registered with the Federal
9 Reserve System if such stock—

10 “(A) is required to be held by an individual
11 under applicable Federal or State law in order
12 to permit such individual to serve as a director,
13 and

14 “(B) is subject to an agreement with such
15 bank or company (or a corporation which con-
16 trols (within the meaning of section 368(e))
17 such bank or company) pursuant to which the
18 holder is required to sell back such stock (at
19 the same price as the individual acquired such
20 stock) upon ceasing to hold the office of direc-
21 tor.

22 “(3) CROSS REFERENCE.—

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

23 (b) Section 1368 (relating to distributions) is amend-
24 ed by adding at the end the following new subsection:



1 “(f) RESTRICTED BANK DIRECTOR STOCK.—If a di-
2 rector receives a distribution (not in part or full payment
3 in exchange for stock) from an S corporation with respect
4 to any restricted bank director stock (as defined in section
5 1361(f)), the amount of such distribution—

6 “(1) shall be includible in gross income of the
7 director, and

8 “(2) shall be deductible by the corporation for
9 the taxable year of such corporation in which or with
10 which ends the taxable year in which such amount
11 in included in the gross income of the director.”.

12 (c) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2003.

15 **SEC. 1049. RELIEF FROM INADVERTENTLY INVALID QUALI-**
16 **FIED SUBCHAPTER S SUBSIDIARY ELECTIONS**
17 **AND TERMINATIONS.**

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

20 (1) by inserting “, section 1361(b)(3)(B)(ii),”
21 after “subsection (a)” in paragraph (1),

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

24 (3) by amending paragraph (3)(A) to read as
25 follows:



1 amended by inserting “and in the case of information re-
2 turns required under part III of subchapter A of chapter
3 61” after “Secretary”.

4 (b) EFFECTIVE DATE.—The amendment made by
5 this section shall apply to taxable years beginning after
6 December 31, 2003.

7 **SEC. 1051. REPAYMENT OF LOANS FOR QUALIFYING EM-**
8 **PLOYER SECURITIES.**

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

12 “(7) S CORPORATION REPAYMENT OF LOANS
13 FOR QUALIFYING EMPLOYER SECURITIES.—A plan
14 shall not be treated as violating the requirements of
15 section 401 or 409 or subsection (e)(7), or as engag-
16 ing in a prohibited transaction for purposes of sub-
17 section (d)(3), merely by reason of any distribution
18 (as described in section 1368(a)) with respect to S
19 corporation stock that constitutes qualifying em-
20 ployer securities, which in accordance with the plan
21 provisions is used to make payments on a loan de-
22 scribed in subsection (d)(3) the proceeds of which
23 were used to acquire such qualifying employer secu-
24 rities (whether or not allocated to participants). The
25 preceding sentence shall not apply in the case of a



1 distribution which is paid with respect to any em-
2 ployer security which is allocated to a participant
3 unless the plan provides that employer securities
4 with a fair market value of not less than the amount
5 of such distribution are allocated to such participant
6 for the year which (but for the preceding sentence)
7 such distribution would have been allocated to such
8 participant.”.

9 (b) EFFECTIVE DATE.—The amendment made by
10 this section shall apply to distributions with respect to S
11 corporation stock made after December 31, 2003.

12 **Subtitle F—Protecting Employee** 13 **Benefits**

14 **SEC. 1061. TREATMENT OF NONQUALIFIED DEFERRED** 15 **COMPENSATION PLANS.**

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

19 **“SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED** 20 **COMPENSATION UNDER NONQUALIFIED DE-** 21 **FERRED COMPENSATION PLANS.**

22 “(a) RULES RELATING TO CONSTRUCTIVE RE-
23 CEIPT.—

24 “(1) IN GENERAL.—



1 “(A) GROSS INCOME INCLUSION.—In the
2 case of a nonqualified deferred compensation
3 plan, all compensation deferred under the plan
4 for all taxable years (to the extent not subject
5 to a substantial risk of forfeiture and not pre-
6 viously included in gross income) shall be in-
7 cludible in gross income for the taxable year
8 unless at all times during the taxable year the
9 plan meets the requirements of paragraphs (2),
10 (3), and (4) and is operated in accordance with
11 such requirements.

12 “(B) INTEREST ON TAX LIABILITY PAY-
13 ABLE WITH RESPECT TO PREVIOUSLY DE-
14 FERRED COMPENSATION.—

15 “(i) IN GENERAL.—If compensation is
16 required to be included in gross income
17 under subparagraph (A) for a taxable year,
18 the tax imposed by this chapter for such
19 taxable year shall be increased by the
20 amount of interest determined under
21 clause (ii).

22 “(ii) INTEREST.—For purposes of
23 clause (i), the interest determined under
24 this clause for any taxable year is the
25 amount of interest at the underpayment



1 rate plus 1 percentage point on the under-
2 payments that would have occurred had
3 the deferred compensation been includible
4 in gross income for the taxable year in
5 which first deferred or, if later, the first
6 taxable year in which such deferred com-
7 pensation is not subject to a substantial
8 risk of forfeiture.

9 “(2) DISTRIBUTIONS.—

10 “(A) IN GENERAL.—The requirements of
11 this paragraph are met if the plan provides that
12 compensation deferred under the plan may not
13 be distributed earlier than—

14 “(i) separation from service as deter-
15 mined by the Secretary (except as provided
16 in subparagraph (B)(i)),

17 “(ii) disability (as defined by section
18 223(d) of the Social Security Act),

19 “(iii) death,

20 “(iv) a specified time (or pursuant to
21 a fixed schedule) specified under the plan
22 as of the date of the deferral of such com-
23 pensation,

24 “(v) to the extent provided by the
25 Secretary, a change in the ownership or ef-



1 fective control of the corporation, or in the
2 ownership of a substantial portion of the
3 assets of the corporation, or

4 “(vi) the occurrence of an unforesee-
5 able emergency.

6 “(B) SPECIAL RULES.—

7 “(i) SPECIFIED EMPLOYEES.—In the
8 case of specified employees, the require-
9 ment of subparagraph (A)(i) is met only if
10 distributions may not be made earlier than
11 6 months after the date of separation from
12 service. For purposes of the preceding sen-
13 tence, a specified employee is a key em-
14 ployee (as defined in section 416(i)) of a
15 corporation the stock in which is publicly
16 traded on an established securities market
17 or otherwise.

18 “(ii) UNFORESEEABLE EMER-
19 GENCY.—For purposes of subparagraph
20 (A)(vi)—

21 “(I) IN GENERAL.—The term
22 ‘unforeseeable emergency’ means a se-
23 vere financial hardship to the partici-
24 pant resulting from a sudden and un-
25 expected illness or accident of the par-



1 participant, the participant’s spouse, or a
2 dependent (as defined in section
3 152(a)) of the participant, loss of the
4 participant’s property due to casualty,
5 or other similar extraordinary and un-
6 foreseeable circumstances arising as a
7 result of events beyond the control of
8 the participant.

9 “(II) LIMITATION ON DISTRIBUTIONS.—The requirement of subpara-
10 graph (A)(vi) is met only if, as deter-
11 mined under regulations of the Sec-
12 retary, the amounts distributed with
13 respect to an emergency do not exceed
14 the amounts necessary to satisfy such
15 emergency plus amounts necessary to
16 pay taxes reasonably anticipated as a
17 result of the distribution, after taking
18 into account the extent to which such
19 hardship is or may be relieved
20 through reimbursement or compensa-
21 tion by insurance or otherwise or by
22 liquidation of the participant’s assets
23 (to the extent the liquidation of such
24



1 assets would not itself cause severe fi-
2 nancial hardship).

3 “(3) ACCELERATION OF BENEFITS.—The re-
4 quirements of this paragraph are met if the plan
5 does not permit the acceleration of the time or
6 schedule of any payment under the plan, except as
7 provided in regulations by the Secretary.

8 “(4) ELECTIONS.—

9 “(A) IN GENERAL.—The requirements of
10 this paragraph are met if the requirements of
11 subparagraphs (B) and (C) are met.

12 “(B) INITIAL DEFERRAL DECISION.—The
13 requirements of this subparagraph are met if
14 the plan provides that compensation for services
15 performed during a taxable year may be de-
16 ferred at the participant’s election only if the
17 election to defer such compensation is made
18 during the preceding taxable year or at such
19 other time as provided in regulations. In the
20 case of the first year in which a participant be-
21 comes eligible to participate in the plan, such
22 election may be made with respect to services to
23 be performed subsequent to the election within
24 30 days after the date the participant becomes
25 eligible to participate in such plan.



1 “(C) CHANGES IN TIME AND FORM OF DIS-
2 TRIBUTION.—The requirements of this subpara-
3 graph are met if, in the case of a plan which
4 permits under a subsequent election a delay in
5 a payment or a change in the form of
6 payment—

7 “(i) the plan requires that such elec-
8 tion may not take effect until at least 12
9 months after the date on which the elec-
10 tion is made,

11 “(ii) in the case an election related to
12 a payment not described in clause (ii), (iii),
13 or (vi) of paragraph (2)(A), the plan re-
14 quires that the first payment with respect
15 to which such election is made be deferred
16 for a period of not less than 5 years from
17 the date such payment would otherwise
18 have been made, and

19 “(iii) the plan requires that any elec-
20 tion related to a payment described in
21 paragraph (2)(A)(iv) may not be made less
22 than 12 months prior to the date of the
23 first scheduled payment under such para-
24 graph.

25 “(b) RULES RELATING TO FUNDING.—



1 “(1) OFFSHORE PROPERTY IN A TRUST.—In
2 the case of assets held in a trust or set aside (di-
3 rectly or indirectly) in another arrangement, as de-
4 termined by the Secretary, for purposes of paying
5 deferred compensation under a nonqualified deferred
6 compensation plan, for purposes of section 83 such
7 assets shall be treated as property transferred in
8 connection with the performance of services whether
9 or not such assets are available to satisfy claims of
10 general creditors—

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

13 “(B) at the time transferred if such assets
14 are subsequently transferred outside of the
15 United States.

16 “(2) EMPLOYER’S FINANCIAL HEALTH.—In the
17 case of a nonqualified deferred compensation plan,
18 there is a transfer of property within the meaning
19 of section 83 as of the earlier of—

20 “(A) the date on which the plan first pro-
21 vides that assets will become restricted to the
22 provision of benefits under the plan in connec-
23 tion with a change in the employer’s financial
24 health, or



1 “(B) the date on which assets are so re-
2 stricted.

3 “(3) INCOME INCLUSION FOR OFFSHORE
4 TRUSTS AND EMPLOYER’S FINANCIAL HEALTH.—For
5 each taxable year that assets treated as transferred
6 under this subsection remain set aside in a trust or
7 other arrangement subject to paragraph (1) or (2),
8 any increase in value in, or earnings with respect to,
9 such assets shall be treated as an additional transfer
10 of property under this subsection (to the extent not
11 previously included in income).

12 “(4) INTEREST ON TAX LIABILITY PAYABLE
13 WITH RESPECT TO TRANSFERRED PROPERTY.—

14 “(A) IN GENERAL.—If amounts are re-
15 quired to be included in gross income by reason
16 of paragraph (1) or (2) for a taxable year, the
17 tax imposed by this chapter for such taxable
18 year shall be increased by the amount of inter-
19 est determined under subparagraph (B).

20 “(B) INTEREST.—The interest determined
21 under this subparagraph for any taxable year is
22 the amount of interest at the underpayment
23 rate plus 1 percentage point on the underpay-
24 ments that would have occurred had the
25 amounts so required to be included in gross in-



1 come by paragraph (1) or (2) been includible in
2 gross income for the taxable year in which such
3 assets were first set aside (directly or indi-
4 rectly) in a trust (or other arrangement deter-
5 mined by the Secretary) for purposes of the
6 nonqualified deferred compensation plan.

7 “(c) NO INFERENCE ON EARLIER INCOME INCLU-
8 SION OR REQUIREMENT OF LATER INCLUSION.—Nothing
9 in this section shall be construed to prevent the inclusion
10 of amounts in gross income under any other provision of
11 this chapter or any other rule of law earlier than the time
12 provided in this section. Any amount included in gross in-
13 come under this section shall not be required to be in-
14 cluded in gross income under any other provision of this
15 chapter or any other rule of law later than the time pro-
16 vided in this section.

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

19 “(1) NONQUALIFIED DEFERRED COMPENSA-
20 TION PLAN.—The term ‘nonqualified deferred com-
21 pensation plan’ means any plan that provides for the
22 deferral of compensation, other than—

23 “(A) a qualified employer plan, and



1 “(B) any bona fide vacation leave, sick
2 leave, compensatory time, disability pay, or
3 death benefit plan.

4 “(2) QUALIFIED EMPLOYER PLAN.—The term
5 ‘qualified employer plan’ means—

6 “(A) any plan, contract, pension, account,
7 or trust described in subparagraph (A) or (B)
8 of section 219(g)(5), and

9 “(B) any eligible deferred compensation
10 plan (within the meaning of section 457(b)) of
11 an employer described in section 457(e)(1)(A).

12 “(3) PLAN INCLUDES ARRANGEMENTS, ETC.—
13 The term ‘plan’ includes any agreement or arrange-
14 ment, including an agreement or arrangement that
15 includes one person.

16 “(4) SUBSTANTIAL RISK OF FORFEITURE.—The
17 rights of a person to compensation are subject to a
18 substantial risk of forfeiture if such person’s rights
19 to such compensation are conditioned upon the fu-
20 ture performance of substantial services by any indi-
21 vidual.

22 “(5) TREATMENT OF EARNINGS.—References to
23 deferred compensation shall be treated as including
24 references to income (whether actual or notional) at-
25 tributable to such compensation or such income.



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

5 “(1) providing for the determination of
6 amounts of deferral in the case of a nonqualified de-
7 ferred compensation plan which is a defined benefit
8 plan,

9 “(2) relating to changes in the ownership and
10 control of a corporation or assets of a corporation
11 for purposes of subsection (a)(2)(A)(v),

12 “(3) exempting arrangements from the applica-
13 tion of subsection (b) if such arrangements will not
14 result in an improper deferral of United States tax
15 and will not result in assets being effectively beyond
16 the reach of creditors,

17 “(4) defining financial health for purposes of
18 subsection (b)(2), and

19 “(5) disregarding a substantial risk of for-
20 feiture in cases where necessary to carry out the
21 purposes of this section.”.

22 (b) W-2 FORMS.—

23 (1) IN GENERAL.—Subsection (a) of section
24 6051 (relating to receipts for employees) is amended
25 by striking “and”, by striking the period at the end



1 of paragraph (11) and inserting “, and”, and by in-
2 sserting after paragraph (11) the following new para-
3 graph:

4 “(12) the total amount of deferrals under a
5 nonqualified deferred compensation plan (within the
6 meaning of section 409A(d)).”.

7 (2) THRESHOLD.—Subsection (a) of section
8 6051 is amended by adding at the end the following:
9 “In the case of the amounts required to be shown
10 by paragraph (12), the Secretary (by regulation)
11 may establish a minimum amount of deferrals below
12 which paragraph (12) does not apply and may pro-
13 vide that paragraph (12) does not apply with respect
14 to amounts of deferrals which are not reasonably as-
15 certainable.”.

16 (c) CONFORMING AND CLERICAL AMENDMENTS.—

17 (1) Section 414(b) is amended by inserting
18 “409A,” after “408(p),”.

19 (2) Section 414(c) is amended by inserting
20 “409A,” after “408(p),”.

21 (3) The table of sections for such subpart A is
22 amended by adding at the end the following new
23 item:

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

24 (d) EFFECTIVE DATE.—



1 (1) IN GENERAL.—Except as otherwise pro-
2 vided in this subsection, the amendments made by
3 this section shall apply to amounts deferred in tax-
4 able years beginning after December 31, 2003.

5 (2) AMOUNTS DEFERRED IN 2004 UNDER CER-
6 TAIN IRREVOCABLE ELECTIONS AND BINDING AR-
7 RANGEMENTS.—The amendments made by this sec-
8 tion shall not apply to amounts deferred in taxable
9 years beginning after December 31, 2003, and be-
10 fore January 1, 2005, pursuant to an irrevocable
11 election or binding arrangement made before Octo-
12 ber 24, 2003.

13 (3) EARNINGS ATTRIBUTABLE TO AMOUNT PRE-
14 VIOUSLY DEFERRED.—The amendments made by
15 this section shall apply to earnings on deferred com-
16 pensation only to the extent that such amendments
17 apply to such compensation.

18 (e) GUIDANCE RELATING TO CHANGE OF OWNER-
19 SHIP OR CONTROL.—Not later than 90 days after the date
20 of the enactment of this Act, the Secretary of the Treasury
21 shall issue guidance on what constitutes a change in own-
22 ership or effective control for purposes of section 409A
23 of the Internal Revenue Code of 1986, as added by this
24 section.



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

14 **SEC. 1062. EXCLUSION OF INCENTIVE STOCK OPTIONS AND**
15 **EMPLOYEE STOCK PURCHASE PLAN STOCK**
16 **OPTIONS FROM WAGES.**

17 (a) EXCLUSION FROM EMPLOYMENT TAXES.—

18 (1) SOCIAL SECURITY TAXES.—

19 (A) Section 3121(a) (relating to definition
20 of wages) is amended by striking “or” at the
21 end of paragraph (20), by striking the period at
22 the end of paragraph (21) and inserting “; or”,
23 and by inserting after paragraph (21) the fol-
24 lowing new paragraph:

25 “(22) remuneration on account of—



1 “(A) a transfer of a share of stock to any
2 individual pursuant to an exercise of an incen-
3 tive stock option (as defined in section 422(b))
4 or under an employee stock purchase plan (as
5 defined in section 423(b)), or

6 “(B) any disposition by the individual of
7 such stock.”.

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

14 “(19) Remuneration on account of—

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

21 “(B) any disposition by the individual of
22 such stock.”.

23 (2) RAILROAD RETIREMENT TAXES.—Sub-
24 section (e) of section 3231 is amended by adding at
25 the end the following new paragraph:



1 “(11) QUALIFIED STOCK OPTIONS.—The term
2 ‘compensation’ shall not include any remuneration
3 on account of—

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

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

11 (3) UNEMPLOYMENT TAXES.—Section 3306(b)
12 (relating to definition of wages) is amended by strik-
13 ing “or” at the end of paragraph (16), by striking
14 the period at the end of paragraph (17) and insert-
15 ing “; or”, and by inserting after paragraph (17) the
16 following new paragraph:

17 “(18) remuneration on account of—

18 “(A) a transfer of a share of stock to any
19 individual pursuant to an exercise of an incen-
20 tive stock option (as defined in section 422(b))
21 or under an employee stock purchase plan (as
22 defined in section 423(b)), or

23 “(B) any disposition by the individual of
24 such stock.”.



1 (b) WAGE WITHHOLDING NOT REQUIRED ON DIS-
2 QUALIFYING DISPOSITIONS.—Section 421(b) (relating to
3 effect of disqualifying dispositions) is amended by adding
4 at the end the following new sentence: “No amount shall
5 be required to be deducted and withheld under chapter
6 24 with respect to any increase in income attributable to
7 a disposition described in the preceding sentence.”.

8 (c) WAGE WITHHOLDING NOT REQUIRED ON COM-
9 PENSATION WHERE OPTION PRICE IS BETWEEN 85 PER-
10 CENT AND 100 PERCENT OF VALUE OF STOCK.—Section
11 423(c) (relating to special rule where option price is be-
12 tween 85 percent and 100 percent of value of stock) is
13 amended by adding at the end the following new sentence:
14 “No amount shall be required to be deducted and withheld
15 under chapter 24 with respect to any amount treated as
16 compensation under this subsection.”.

17 (d) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to stock acquired pursuant to op-
19 tions exercised after the date of the enactment of this Act.

20 **SEC. 1063. EXTENSION OF TRANSFERS OF EXCESS PENSION**
21 **ASSETS TO RETIREE HEALTH ACCOUNTS.**

22 Paragraph (5) of section 420(b) (relating to expira-
23 tion) is amended by striking “December 31, 2005” and
24 inserting “December 31, 2013”.



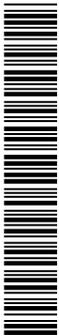
1 **Subtitle G—Treatment of Active**
2 **Income**

3 **SEC. 1071. MEMBER STATES OF THE EUROPEAN UNION**
4 **TREATED AS A SINGLE COUNTRY FOR CER-**
5 **TAIN PURPOSES.**

6 (a) **IN GENERAL.**—Subsection (d) of section 954 is
7 amended by adding at the end the following new para-
8 graph:

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

16 (b) **EFFECTIVE DATE.**—The amendment made by
17 this section shall apply to taxable years of foreign corpora-
18 tions beginning after December 31, 2008, and to taxable
19 years of United States shareholders with or within which
20 such taxable years of foreign corporations end.



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

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

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

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



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

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

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

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

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

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



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

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

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

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

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

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

15 (1) **IN GENERAL.**—Subsection (c) of section
16 542 (relating to exceptions) is amended—

17 (A) by striking paragraph (5) and insert-
18 ing the following:

19 “(5) a foreign corporation,”

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

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



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

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

8 “(H) PERSONAL SERVICE CONTRACTS.—

9 “(i) Amounts received under a con-
10 tract under which the corporation is to fur-
11 nish personal services if—

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

17 “(II) the individual who is to per-
18 form the services is designated (by
19 name or by description) in the con-
20 tract, and

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

23 This subparagraph shall apply with respect to
24 amounts received for services under a particular
25 contract only if at some time during the taxable



1 year 25 percent or more in value of the out-
2 standing stock of the corporation is owned, di-
3 rectly or indirectly, by or for the individual who
4 has performed, is to perform, or may be des-
5 ignated (by name or by description) as the one
6 to perform, such services.”

7 (c) CONFORMING AMENDMENTS.—

8 (1) Clause (iii) of section 1(h)(11)(C) is amend-
9 ed by striking “a foreign personal holding company
10 (as defined in section 552), a foreign investment
11 company (as defined in section 1246(b)), or”.

12 (2) Paragraph (2) of section 171(c) is
13 amended—

14 (A) by striking “, or by a foreign personal
15 holding company, as defined in section 552”,
16 and

17 (B) by striking “, or foreign personal hold-
18 ing company”.

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

21 (4) Section 312 is amended by striking sub-
22 section (j).

23 (5) Subsection (m) of section 312 is amended
24 by striking “, a foreign investment company (within
25 the meaning of section 1246(b)), or a foreign per-



1 sonal holding company (within the meaning of sec-
2 tion 552)”.

3 (6) Subsection (e) of section 443 is amended by
4 striking paragraph (3) and by redesignating para-
5 graphs (4) and (5) as paragraphs (3) and (4), re-
6 spectively.

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

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

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

19 (10) Section 563 is amended—

20 (A) by striking subsection (c),

21 (B) by redesignating subsection (d) as sub-
22 section (c), and

23 (C) by striking “subsection (a), (b), or (c)”
24 in subsection (c) (as so redesignated) and in-
25 serting “subsection (a) or (b)”.



1 (11) Subsection (d) of section 751 is amended
2 by adding “and” at the end of paragraph (2), by
3 striking paragraph (3), by redesignating paragraph
4 (4) as paragraph (3), and by striking “paragraph
5 (1), (2), or (3)” in paragraph (3) (as so redesign-
6 ated) and inserting “paragraph (1) or (2)”.

7 (12) Paragraph (2) of section 864(d) is amend-
8 ed by striking subparagraph (A) and by redesign-
9 ating subparagraphs (B) and (C) as subparagraphs
10 (A) and (B), respectively.

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

13 “(A) which is treated as a controlled for-
14 eign corporation for any purpose under subpart
15 F of part III of this subchapter, and”.

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

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

21 “(3) UNITED STATES SHAREHOLDER.—The
22 term ‘United States shareholder’ has the meaning
23 given to such term by section 951(b), except that, in
24 the case of a foreign corporation having related per-
25 son insurance income (as defined in section



1 953(c)(2)), the Secretary may treat any person as a
2 United States shareholder for purposes of this sec-
3 tion if such person is treated as a United States
4 shareholder under section 953(c)(1).”

5 (D) Subsection (c) of section 898 is amended to
6 read as follows:

7 “(c) DETERMINATION OF REQUIRED YEAR.—

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

9 “(A) the majority U.S. shareholder year,
10 or

11 “(B) if there is no majority U.S. share-
12 holder year, the taxable year prescribed under
13 regulations.

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

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

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



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

3 “(ii) each United States shareholder
4 not described in clause (i) whose stock was
5 treated as owned under subsection
6 (b)(2)(B) by any shareholder described in
7 such clause.

8 “(B) TESTING DAY.—The testing days
9 shall be—

10 “(i) the first day of the corporation’s
11 taxable year (determined without regard to
12 this section), or

13 “(ii) the days during such representa-
14 tive period as the Secretary may pre-
15 scribe.”

16 (14) Clause (ii) of section 904(d)(2)(A) is
17 amended to read as follows:

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



1 (15)(A) Subparagraph (A) of section 904(g)(1)
2 is amended by adding “or” at the end of clause (i),
3 by striking clause (ii), and by redesignating clause
4 (iii) as clause (ii).

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

8 (16) Section 951 is amended by striking sub-
9 sections (c) and (d) and by redesignating subsections
10 (e) and (f) as subsections (c) and (d), respectively.

11 (17) Paragraph (3) of section 989(b) is amend-
12 ed by striking “, 551(a),”.

13 (18) Paragraph (5) of section 1014(b) is
14 amended by inserting “and before January 1,
15 2008,” after “August 26, 1937,”.

16 (19) Subsection (a) of section 1016 is amended
17 by striking paragraph (13).

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

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

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



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

3 (B) The amendment made by subparagraph (A)
4 shall apply to taxable years beginning after Decem-
5 ber 31, 2006.

6 (21) Section 1223 is amended by striking para-
7 graph (10) and by redesignating the following para-
8 graphs accordingly.

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

13 (23) Paragraph (2) of section 1260(c) is
14 amended by striking subparagraphs (H) and (I) and
15 by redesignating subparagraph (J) as subparagraph
16 (H).

17 (24)(A) Subparagraph (F) of section
18 1291(b)(3) is amended by striking “551(d), 959(a),”
19 and inserting “959(a)”.

20 (B) Subsection (e) of section 1291 is amended
21 by inserting “(as in effect on the day before the date
22 of the enactment of the American Jobs Creation Act
23 of 2003)” after “section 1246”.

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



1 “(2) ELECTION NOT PERMITTED WHERE
2 AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION
3 951.—The taxpayer may not make an election under
4 paragraph (1) with respect to the undistributed
5 PFIC earnings tax liability attributable to a quali-
6 fied electing fund for the taxable year if any amount
7 is includible in the gross income of the taxpayer
8 under section 951 with respect to such fund for such
9 taxable year.”

10 (26) Section 6035 is hereby repealed.

11 (27) Subparagraph (D) of section 6103(e)(1) is
12 amended by striking clause (iv) and redesignating
13 clauses (v) and (vi) as clauses (iv) and (v), respec-
14 tively.

15 (28) Subparagraph (B) of section 6501(e)(1) is
16 amended to read as follows:

17 “(B) CONSTRUCTIVE DIVIDENDS.—If the
18 taxpayer omits from gross income an amount
19 properly includible therein under section
20 951(a), the tax may be assessed, or a pro-
21 ceeding in court for the collection of such tax
22 may be done without assessing, at any time
23 within 6 years after the return was filed.”

24 (29) Subsection (a) of section 6679 is
25 amended—



1 (A) by striking “6035, 6046, and 6046A”
2 in paragraph (1) and inserting “6046 and
3 6046A”, and

4 (B) by striking paragraph (3).

5 (30) Sections 170(f)(10)(A), 508(d), 4947, and
6 4948(c)(4) are each amended by striking
7 “556(b)(2),” each place it appears.

8 (31) The table of parts for subchapter G of
9 chapter 1 is amended by striking the item relating
10 to part III.

11 (32) The table of sections for part IV of sub-
12 chapter P of chapter 1 is amended by striking the
13 items relating to sections 1246 and 1247.

14 (33) The table of sections for subpart A of part
15 III of subchapter A of chapter 61 is amended by
16 striking the item relating to section 6035.

17 (34) Sections 163(e)(3)(B)(i) and
18 267(a)(3)(B)(i) are each amended by—

19 (A) striking “a foreign personal holding
20 company (as defined in section 552),” and

21 (B) striking the comma after “(as defined
22 in section 957)”.

23 (d) EFFECTIVE DATE.—Except as otherwise pro-
24 vided in this section, the amendments made by this section
25 shall apply to taxable years of foreign corporations begin-



1 ning after December 31, 2006, and to taxable years of
2 United States shareholders with or within which such tax-
3 able years of foreign corporations end.

4 **SEC. 1075. CLARIFICATION OF TREATMENT OF PIPELINE**
5 **TRANSPORTATION INCOME.**

6 (a) IN GENERAL.—Section 954(g)(1) (defining for-
7 eign base company oil related income) is amended by strik-
8 ing “or” at the end of subparagraph (A), by striking the
9 period at the end of subparagraph (B) and inserting “,
10 or”, and by inserting after subparagraph (B) the following
11 new subparagraph:

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

14 (b) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to taxable years of foreign corpora-
16 tions beginning after December 31, 2004, and to taxable
17 years of United States shareholders with or within which
18 such taxable years of foreign corporations end.

19 **SEC. 1076. DETERMINATION OF FOREIGN PERSONAL HOLD-**
20 **ING COMPANY INCOME WITH RESPECT TO**
21 **TRANSACTIONS IN COMMODITIES.**

22 (a) IN GENERAL.—Clauses (i) and (ii) of section
23 954(e)(1)(C) (relating to commodity transactions) are
24 amended to read as follows:



1 “(i) arise out of commodity hedging
2 transactions (as defined in paragraph
3 (6)(A)),

4 “(ii) are active business gains or
5 losses from the sale of commodities, but
6 only if substantially all of the controlled
7 foreign corporation’s commodities are
8 property described in paragraph (1), (2),
9 or (8) of section 1221(a), or”.

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

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

15 “(A) COMMODITY HEDGING TRANS-
16 ACTIONS.—For purposes of paragraph
17 (1)(C)(i), the term ‘commodity hedging trans-
18 action’ means any transaction with respect to a
19 commodity if such transaction—

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

22 “(I) without regard to subpara-
23 graph (A)(ii) thereof,

24 “(II) by applying subparagraph
25 (A)(i) thereof by substituting ‘ordi-



1 nary property or property described in
2 section 1231(b)' for 'ordinary prop-
3 erty', and

4 “(III) by substituting ‘controlled
5 foreign corporation’ for ‘taxpayer’
6 each place it appears, and

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

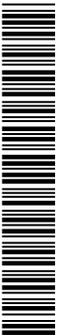
9 “(B) REGULATIONS.—The Secretary shall
10 prescribe such regulations as are appropriate to
11 carry out the purposes of paragraph (1)(C) in
12 the case of transactions involving related per-
13 sons.”

14 (c) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to transactions entered into after
16 December 31, 2004.

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

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

22 (1) by striking paragraph (4) of subsection (a)
23 (relating to foreign base company shipping income),
24 and



1 (2) by striking subsection (f) (relating to for-
2 eign base company shipping income).

3 (b) SAFE HARBOR FOR CERTAIN LEASING ACTIVI-
4 TIES.—Subparagraph (A) of section 954(c)(2) is amended
5 by adding at the end the following new sentence: “For
6 purposes of the preceding sentence, rents derived from
7 leasing an aircraft or vessel in foreign commerce shall not
8 fail to be treated as derived in the active conduct of a
9 trade or business if, as determined under regulations pre-
10 scribed by the Secretary, the active leasing expenses are
11 not less than 10 percent of the profit on the lease.”

12 (c) CONFORMING AMENDMENTS.—

13 (1) Section 952(c)(1)(B)(iii) is amended by
14 striking subclause (I) and redesignating subclauses
15 (II) through (VI) as subclauses (I) through (V), re-
16 spectively.

17 (2) Subsection (b) of section 954 is amended—

18 (A) by striking “the foreign base shipping
19 income,” in paragraph (5),

20 (B) by striking paragraphs (6) and (7),
21 and

22 (C) by redesignating paragraph (8) as
23 paragraph (6).

24 (d) EFFECTIVE DATE.—The amendments made by
25 this section shall apply to taxable years of foreign corpora-



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

4 **SEC. 1078. MODIFICATION OF SUBPART F EXEMPTION FOR**
5 **ACTIVE FINANCING.**

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

8 “(E) DIRECT CONDUCT OF ACTIVITIES.—
9 For purposes of subparagraph (A)(ii)(II), an
10 activity shall be treated as conducted directly by
11 an eligible controlled foreign corporation or
12 qualified business unit in its home country if
13 the activity is performed by employees of a re-
14 lated person and—

15 “(i) the related person is an eligible
16 controlled foreign corporation the home
17 country of which is the same as the home
18 country of the corporation or unit to which
19 subparagraph (A)(ii)(II) is being applied,

20 “(ii) the activity is performed in the
21 home country of the related person, and

22 “(iii) the related person is com-
23 pensated on an arm’s-length basis for the
24 performance of the activity by its employ-
25 ees and such compensation is treated as



1 earned by such person in its home country
2 for purposes of the home country's tax
3 laws.”.

4 (b) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to taxable years of foreign corpora-
6 tions beginning after December 31, 2004, and to taxable
7 years of United States shareholders with or within which
8 such taxable years of foreign corporations end.

9 **SEC. 1079. PARTIAL EXCLUSION FOR INCOME ATTRIB-**
10 **UTABLE TO FILMS USED OUTSIDE THE**
11 **UNITED STATES.**

12 (a) IN GENERAL.—Part III of subchapter B of chap-
13 ter 1 (relating to items specifically excluded from gross
14 income) is amended by inserting after section 139 the fol-
15 lowing new section:

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

18 “(a) EXCLUSION.—

19 “(1) IN GENERAL.—There shall be excluded
20 from gross income an amount equal to the applicable
21 percentage of qualified film income.

22 “(2) APPLICABLE PERCENTAGE.—For purposes
23 of paragraph (1), the applicable percentage shall be
24 determined in accordance with the following table:

“For taxable years ending in calendar year—	The applicable percentage is—
2007	1



2008	2
2009	3
2010	5
2011	8
2012	9
2013 or thereafter	10.

1 “(b) QUALIFIED FILM INCOME.—For purposes of
2 this section—

3 “(1) IN GENERAL.—The term ‘qualified film in-
4 come’ means gross income from a license of a quali-
5 fied film in the ordinary course of a trade or busi-
6 ness for the exploitation or direct use outside the
7 United States less any associated film costs.

8 “(2) EXCEPTIONS.—

9 “(A) CERTAIN USES.—Such term does not
10 include exploitation of characters, soundtracks,
11 designs, scripts, scores, or any other ancillary
12 intangibles associated with the qualified film.

13 “(B) RELATED PERSON LICENSE.—

14 “(i) IN GENERAL.—Such term does
15 not include any amount from the license of
16 a qualified film to a related person.

17 “(ii) EXCEPTION.—Clause (i) shall
18 not apply if such film is held for license by
19 such related person to an unrelated person
20 for the direct use or exploitation by such
21 unrelated person outside the United
22 States.



1 “(iii) RELATED PERSON.—For pur-
2 poses of this subparagraph, a person shall
3 be related to another person if such per-
4 sons are treated as a single employer
5 under subsection (a) or (b) of section 52 or
6 subsection (m) or (o) of section 414, ex-
7 cept that determinations under subsections
8 (a) and (b) of section 52 shall be made
9 without regard to section 1563(b).

10 “(c) OTHER DEFINITIONS.—For purposes of this
11 section—

12 “(1) QUALIFIED FILM.—The term ‘qualified
13 film’ means property described in section 168(f)(3)
14 the original use of which commences after December
15 31, 2006. Such term does not include property with
16 respect to which records are required to be main-
17 tained under section 2257 of title 18, United States
18 Code.

19 “(2) ASSOCIATED FILM COSTS.—The term ‘as-
20 sociated film costs’ means any expense properly ap-
21 portioned and allocated to income taken into account
22 under subsection (b)(1), determined as provided
23 under regulations prescribed by the Secretary.

24 “(d) ELECTION.—The taxpayer may elect not to
25 apply this section to a qualified film. Such election shall



1 be made by the due date (including extensions of time)
2 for filing the return for the taxable year in which such
3 film is placed in service, and, once made for such film,
4 such election shall be irrevocable.

5 “(e) DENIAL OF FOREIGN TAX CREDIT.—

6 “(1) IN GENERAL.—No credit shall be allowed
7 under section 901 for any taxes paid or accrued (or
8 treated as paid or accrued) with respect to the ex-
9 cludable portion of any qualified film income. No de-
10 duction shall be allowed under this chapter for any
11 tax for which credit is not allowable by reason of the
12 preceding sentence.

13 “(2) EXCLUDABLE PORTION.—For purposes of
14 paragraph (1), the taxes paid or accrued (or treated
15 as paid or accrued) with respect to the excludable
16 portion is the amount which bears the same ratio to
17 the amount of taxes paid or accrued (or treated as
18 paid or accrued) with respect to qualified film in-
19 come as the amount excluded under subsection (a)
20 for the taxable year bears to the qualified film in-
21 come for such year.”.

22 (b) CLERICAL AMENDMENT.—The table of sections
23 for part III of subchapter B of chapter 1 is amended by
24 inserting after the item relating to section 139 the fol-
25 lowing new item:



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

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years ending after De-
3 cember 31, 2006.

4 **Subtitle H—Reduction of Double** 5 **Taxation of Earnings**

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

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

11 “(f) ELECTION TO ALLOCATE INTEREST, ETC. ON
12 WORLDWIDE BASIS.—For purposes of this subchapter, at
13 the election of the worldwide affiliated group—

14 “(1) ALLOCATION AND APPORTIONMENT OF IN-
15 TEREST EXPENSE.—

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

22 “(B) TREATMENT OF WORLDWIDE AFFILI-
23 ATED GROUP.—The taxable income of the do-
24 mestic members of a worldwide affiliated group



1 from sources outside the United States shall be
2 determined by allocating and apportioning the
3 interest expense of such domestic members to
4 such income in an amount equal to the excess
5 (if any) of—

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

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

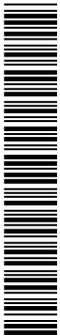
21 “(C) WORLDWIDE AFFILIATED GROUP.—
22 For purposes of this paragraph, the term
23 ‘worldwide affiliated group’ means a group con-
24 sisting of—



1 “(i) the includible members of an af-
2 filiated group (as defined in section
3 1504(a), determined without regard to
4 paragraphs (2) and (4) of section
5 1504(b)), and

6 “(ii) all controlled foreign corpora-
7 tions in which such members in the aggre-
8 gate meet the ownership requirements of
9 section 1504(a)(2) either directly or indi-
10 rectly through applying paragraph (2) of
11 section 958(a) or through applying rules
12 similar to the rules of such paragraph to
13 stock owned directly or indirectly by do-
14 mestic partnerships, trusts, or estates.

15 “(2) ALLOCATION AND APPORTIONMENT OF
16 OTHER EXPENSES.—Expenses other than interest
17 which are not directly allocable or apportioned to
18 any specific income producing activity shall be allo-
19 cated and apportioned as if all members of the affili-
20 ated group were a single corporation. For purposes
21 of the preceding sentence, the term ‘affiliated group’
22 has the meaning given such term by section 1504
23 (determined without regard to paragraph (4) of sec-
24 tion 1504(b)).



1 “(3) TREATMENT OF TAX-EXEMPT ASSETS;
2 BASIS OF STOCK IN NONAFFILIATED 10-PERCENT
3 OWNED CORPORATIONS.—The rules of paragraphs
4 (3) and (4) of subsection (e) shall apply for purposes
5 of this subsection; except that paragraph (4) shall be
6 applied on worldwide affiliated group basis.

7 “(4) TREATMENT OF CERTAIN FINANCIAL IN-
8 STITUTIONS.—

9 “(A) IN GENERAL.—For purposes of para-
10 graph (1), any corporation described in sub-
11 paragraph (B) shall be treated as an includible
12 corporation for purposes of section 1504 only
13 for purposes of applying this subsection sepa-
14 rately to corporations so described.

15 “(B) DESCRIPTION.—A corporation is de-
16 scribed in this subparagraph if—

17 “(i) such corporation is a financial in-
18 stitution described in section 581 or 591,

19 “(ii) the business of such financial in-
20 stitution is predominantly with persons
21 other than related persons (within the
22 meaning of subsection (d)(4)) or their cus-
23 tomers, and

24 “(iii) such financial institution is re-
25 quired by State or Federal law to be oper-



1 ated separately from any other entity
2 which is not such an institution.

3 “(C) TREATMENT OF BANK HOLDING COM-
4 PANIES.—To the extent provided in
5 regulations—

6 “(i) a bank holding company (within
7 the meaning of section 2(a) of the Bank
8 Holding Company Act of 1956 (12 U.S.C.
9 1841(a))),

10 “(ii) a financial holding company
11 (within the meaning of section 2(p) of such
12 Act), and

13 “(iii) any subsidiary of a financial in-
14 stitution described in section 581 or 591,
15 or any such bank or financial holding com-
16 pany, if such subsidiary is predominantly
17 engaged (directly or indirectly) in the ac-
18 tive conduct of a banking, financing, or
19 similar business,

20 shall be treated as a corporation described in
21 subparagraph (B).

22 “(5) ELECTION TO EXPAND FINANCIAL INSTI-
23 TUTION GROUP OF WORLDWIDE GROUP.—



1 “(A) IN GENERAL.—If a worldwide affli-
2 ated group elects the application of this sub-
3 section, all financial corporations which—

4 “(i) are members of such worldwide
5 affiliated group, but

6 “(ii) are not corporations described in
7 paragraph (4)(B),

8 shall be treated as described in paragraph
9 (4)(B) for purposes of applying paragraph
10 (4)(A). This subsection (other than this para-
11 graph) shall apply to any such group in the
12 same manner as this subsection (other than this
13 paragraph) applies to the pre-election worldwide
14 affiliated group of which such group is a part.

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



1 transactions a principal purpose of which is the
2 qualification of any corporation as a financial
3 corporation.

4 “(C) ANTIABUSE RULES.—In the case of a
5 corporation which is a member of an electing fi-
6 nancial institution group, to the extent that
7 such corporation—

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

15 “(I) its average annual dividend
16 (expressed as a percentage of current
17 earnings and profits) during the 5-
18 taxable-year period ending with the
19 taxable year preceding the taxable
20 year, or

21 “(II) 25 percent of its average
22 annual earnings and profits for such
23 5-taxable-year period, or

24 “(ii) deals with any person in any
25 manner not clearly reflecting the income of



1 the corporation (as determined under prin-
2 ciples similar to the principles of section
3 482),

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

16 “(D) ELECTION.—An election under this
17 paragraph with respect to any financial institu-
18 tion group may be made only by the common
19 parent of the pre-election worldwide affiliated
20 group and may be made only for the first tax-
21 able year beginning after December 31, 2008,
22 in which such affiliated group includes 1 or
23 more financial corporations. Such an election,
24 once made, shall apply to all financial corpora-
25 tions which are members of the electing finan-



1 cial institution group for such taxable year and
2 all subsequent years unless revoked with the
3 consent of the Secretary.

4 “(E) DEFINITIONS RELATING TO
5 GROUPS.—For purposes of this paragraph—

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

14 “(ii) ELECTING FINANCIAL INSTITU-
15 TION GROUP.—The term ‘electing financial
16 institution group’ means the group of cor-
17 porations to which this subsection applies
18 separately by reason of the application of
19 paragraph (4)(A) and which includes fi-
20 nancial corporations by reason of an elec-
21 tion under subparagraph (A).

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



1 “(i) providing for the direct allocation
2 of interest expense in other circumstances
3 where such allocation would be appropriate
4 to carry out the purposes of this sub-
5 section,

6 “(ii) preventing assets or interest ex-
7 pense from being taken into account more
8 than once, and

9 “(iii) dealing with changes in mem-
10 bers of any group (through acquisitions or
11 otherwise) treated under this paragraph as
12 an affiliated group for purposes of this
13 subsection.

14 “(6) ELECTION.—An election to have this sub-
15 section apply with respect to any worldwide affiliated
16 group may be made only by the common parent of
17 the domestic affiliated group referred to in para-
18 graph (1)(C) and may be made only for the first
19 taxable year beginning after December 31, 2008, in
20 which a worldwide affiliated group exists which in-
21 cludes such affiliated group and at least one foreign
22 corporation. Such an election, once made, shall apply
23 to such common parent and all other corporations
24 which are members of such worldwide affiliated



1 group for such taxable year and all subsequent years
2 unless revoked with the consent of the Secretary.”.

3 (b) **EXPANSION OF REGULATORY AUTHORITY.**—

4 Paragraph (7) of section 864(e) is amended—

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

9 (2) by striking “and” at the end of subpara-
10 graph (E), by redesignating subparagraph (F) as
11 subparagraph (G), and by inserting after subpara-
12 graph (E) the following new subparagraph:

13 “(F) preventing assets or interest expense
14 from being taken into account more than once,
15 and”.

16 (c) **EFFECTIVE DATE.**—The amendments made by
17 this section shall apply to taxable years beginning after
18 December 31, 2008.

19 **SEC. 1082. RECHARACTERIZATION OF OVERALL DOMESTIC**
20 **LOSS.**

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



1 “(g) RECHARACTERIZATION OF OVERALL DOMESTIC
2 LOSS.—

3 “(1) GENERAL RULE.—For purposes of this
4 subpart and section 936, in the case of any taxpayer
5 who sustains an overall domestic loss for any taxable
6 year beginning after December 31, 2005, that por-
7 tion of the taxpayer’s taxable income from sources
8 within the United States for each succeeding taxable
9 year which is equal to the lesser of—

10 “(A) the amount of such loss (to the extent
11 not used under this paragraph in prior taxable
12 years), or

13 “(B) 50 percent of the taxpayer’s taxable
14 income from sources within the United States
15 for such succeeding taxable year,

16 shall be treated as income from sources without the
17 United States (and not as income from sources with-
18 in the United States).

19 “(2) OVERALL DOMESTIC LOSS DEFINED.—For
20 purposes of this subsection—

21 “(A) IN GENERAL.—The term ‘overall do-
22 mestic loss’ means any domestic loss to the ex-
23 tent such loss offsets taxable income from
24 sources without the United States for the tax-
25 able year or for any preceding taxable year by



1 reason of a carryback. For purposes of the pre-
2 ceding sentence, the term ‘domestic loss’ means
3 the amount by which the gross income for the
4 taxable year from sources within the United
5 States is exceeded by the sum of the deductions
6 properly apportioned or allocated thereto (deter-
7 mined without regard to any carryback from a
8 subsequent taxable year).

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

15 “(3) CHARACTERIZATION OF SUBSEQUENT IN-
16 COME.—

17 “(A) IN GENERAL.—Any income from
18 sources within the United States that is treated
19 as income from sources without the United
20 States under paragraph (1) shall be allocated
21 among and increase the income categories in
22 proportion to the loss from sources within the
23 United States previously allocated to those in-
24 come categories.



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

5 “(4) COORDINATION WITH SUBSECTION (f).—
6 The Secretary shall prescribe such regulations as
7 may be necessary to coordinate the provisions of this
8 subsection with the provisions of subsection (f).”

9 (b) CONFORMING AMENDMENTS.—

10 (1) Section 535(d)(2) is amended by striking
11 “section 904(g)(6)” and inserting “section
12 904(h)(6)”.

13 (2) Subparagraph (A) of section 936(a)(2) is
14 amended by striking “section 904(f)” and inserting
15 “subsections (f) and (g) of section 904”.

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to losses sustained for taxable
18 years beginning after December 31, 2005.

19 **SEC. 1083. REDUCTION TO 2 FOREIGN TAX CREDIT BAS-**
20 **KETS.**

21 (a) IN GENERAL.—Paragraph (1) of section 904(d)
22 (relating to separate application of section with respect to
23 certain categories of income) is amended to read as fol-
24 lows:



1 “(1) IN GENERAL.—The provisions of sub-
2 sections (a), (b), and (c) and sections 902, 907, and
3 960 shall be applied separately with respect to—

4 “(A) passive category income, and

5 “(B) general category income.”

6 (b) CATEGORIES.—Paragraph (2) of section 904(d)
7 is amended by striking subparagraph (B), by redesignig-
8 nating subparagraph (A) as subparagraph (B), and by in-
9 serting before subparagraph (B) (as so redesignated) the
10 following new subparagraph:

11 “(A) CATEGORIES.—

12 “(i) PASSIVE CATEGORY INCOME.—

13 The term ‘passive category income’ means
14 passive income and specified passive cat-
15 egory income.

16 “(ii) GENERAL CATEGORY INCOME.—

17 The term ‘general category income’ means
18 income other than passive category in-
19 come.”

20 (c) SPECIFIED PASSIVE CATEGORY INCOME.—Sub-
21 paragraph (B) of section 904(d)(2), as so redesignated,

22 is amended by adding at the end the following new clause:

23 “(v) SPECIFIED PASSIVE CATEGORY

24 INCOME.—The term ‘specified passive cat-
25 egory income’ means—



1 “(I) dividends from a DISC or
2 former DISC (as defined in section
3 992(a)) to the extent such dividends
4 are treated as income from sources
5 without the United States,

6 “(II) taxable income attributable
7 to foreign trade income (within the
8 meaning of section 923(b)), and

9 “(III) distributions from a FSC
10 (or a former FSC) out of earnings
11 and profits attributable to foreign
12 trade income (within the meaning of
13 section 923(b)) or interest or carrying
14 charges (as defined in section
15 927(d)(1)) derived from a transaction
16 which results in foreign trade income
17 (as defined in section 923(b)).”

18 (d) TREATMENT OF FINANCIAL SERVICES.—Para-
19 graph (2) of section 904(d) is amended by striking sub-
20 paragraph (D), by redesignating subparagraph (C) as sub-
21 paragraph (D), and by inserting before subparagraph (D)
22 (as so redesignated) the following new subparagraph:

23 “(C) TREATMENT OF FINANCIAL SERVICES
24 INCOME AND COMPANIES.—



1 “(i) IN GENERAL.—Financial services
2 income shall be treated as general category
3 income in the case of—

4 “(I) a member of a financial
5 services group, and

6 “(II) any other person if such
7 person is predominantly engaged in
8 the active conduct of a banking, insur-
9 ance, financing, or similar business.

10 “(ii) FINANCIAL SERVICES GROUP.—
11 The term ‘financial services group’ means
12 any affiliated group (as defined in section
13 1504(a) without regard to paragraphs (2)
14 and (3) of section 1504(b)) which is pre-
15 dominantly engaged in the active conduct
16 of a banking, insurance, financing, or simi-
17 lar business. In determining whether such
18 a group is so engaged, there shall be taken
19 into account only the income of members
20 of the group that are—

21 “(I) United States corporations,
22 or

23 “(II) controlled foreign corpora-
24 tions in which such United States cor-
25 porations own, directly or indirectly,



1 at least 80 percent of the total voting
2 power and value of the stock.

3 “(iii) PASS-THRU ENTITIES.—The
4 Secretary shall by regulation specify for
5 purposes of this subparagraph the treat-
6 ment of financial services income received
7 or accrued by partnerships and by other
8 pass-thru entities which are not members
9 of a financial services group.”

10 (e) CONFORMING AMENDMENTS.—

11 (1) Clause (iii) of section 904(d)(2)(B) (relating
12 to exceptions from passive income), as so redesign-
13 nated, is amended by striking subclause (I) and by
14 redesignating subclauses (II) and (III) as subclauses
15 (I) and (II), respectively.

16 (2) Clause (i) of section 904(d)(2)(D) (defining
17 financial services income), as so redesignated, is
18 amended by adding “or” at the end of subclause (I)
19 and by striking subclauses (II) and (III) and insert-
20 ing the following new subclause:

21 “(II) passive income (determined
22 without regard to subparagraph
23 (B)(iii)(II)).”



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

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

6 “(3) LOOK-THRU IN CASE OF CONTROLLED
7 FOREIGN CORPORATIONS.—

8 “(A) IN GENERAL.—Except as otherwise
9 provided in this paragraph, dividends, interest,
10 rents, and royalties received or accrued by the
11 taxpayer from a controlled foreign corporation
12 in which the taxpayer is a United States share-
13 holder shall not be treated as passive category
14 income.

15 “(B) SUBPART F INCLUSIONS.—Any
16 amount included in gross income under section
17 951(a)(1)(A) shall be treated as passive cat-
18 egory income to the extent the amount so in-
19 cluded is attributable to passive category in-
20 come.

21 “(C) INTEREST, RENTS, AND ROYAL-
22 TIES.—Any interest, rent, or royalty which is
23 received or accrued from a controlled foreign
24 corporation in which the taxpayer is a United
25 States shareholder shall be treated as passive



1 category income to the extent it is properly allo-
2 cable (under regulations prescribed by the Sec-
3 retary) to passive category income of the con-
4 trolled foreign corporation.

5 “(D) DIVIDENDS.—Any dividend paid out
6 of the earnings and profits of any controlled
7 foreign corporation in which the taxpayer is a
8 United States shareholder shall be treated as
9 passive category income in proportion to the
10 ratio of—

11 “(i) the portion of the earnings and
12 profits attributable to passive category in-
13 come, to

14 “(ii) the total amount of earnings and
15 profits.

16 “(E) LOOK-THRU APPLIES ONLY WHERE
17 SUBPART F APPLIES.—If a controlled foreign
18 corporation meets the requirements of section
19 954(b)(3)(A) (relating to de minimis rule) for
20 any taxable year, for purposes of this para-
21 graph, none of its foreign base company income
22 (as defined in section 954(a) without regard to
23 section 954(b)(5)) and none of its gross insur-
24 ance income (as defined in section
25 954(b)(3)(C)) for such taxable year shall be



1 treated as passive category income, except that
2 this sentence shall not apply to any income
3 which (without regard to this sentence) would
4 be treated as financial services income. Solely
5 for purposes of applying subparagraph (D),
6 passive income of a controlled foreign corpora-
7 tion shall not be treated as passive category in-
8 come if the requirements of section 954(b)(4)
9 are met with respect to such income.

10 “(F) COORDINATION WITH HIGH-TAXED
11 INCOME PROVISIONS.—

12 “(i) In determining whether any in-
13 come of a controlled foreign corporation is
14 passive category income, subclause (II) of
15 paragraph (2)(B)(iii) shall not apply.

16 “(ii) Any income of the taxpayer
17 which is treated as passive category income
18 under this paragraph shall be so treated
19 notwithstanding any provision of para-
20 graph (2); except that the determination of
21 whether any amount is high-taxed income
22 shall be made after the application of this
23 paragraph.

24 “(G) DIVIDENDS.—Any dividend paid out
25 of the earnings and profits of any controlled



1 foreign corporation in which the taxpayer is a
2 United States shareholder shall be treated as
3 income in a separate category in proportion to
4 the ratio of—

5 “(i) the portion of the earnings and
6 profits attributable to income in such cat-
7 egory, to

8 “(ii) the total amount of earnings and
9 profits.

10 “(H) LOOK-THRU APPLIES TO PASSIVE
11 FOREIGN INVESTMENT COMPANY INCLUSION.—

12 If—

13 “(i) a passive foreign investment com-
14 pany is a controlled foreign corporation,
15 and

16 “(ii) the taxpayer is a United States
17 shareholder in such controlled foreign cor-
18 poration,

19 any amount included in gross income under sec-
20 tion 1293 shall be treated as income in a sepa-
21 rate category to the extent such amount is at-
22 tributable to income in such category.”

23 (5) TREATMENT OF INCOME TAX BASE DIF-
24 FERENCES.—Paragraph (2) of section 904(d) is
25 amended by redesignating subparagraphs (H) and



1 (I) as subparagraphs (I) and (J), respectively, and
2 by inserting after subparagraph (G) the following
3 new subparagraph:

4 “(H) TREATMENT OF INCOME TAX BASE
5 DIFFERENCES.—Tax imposed under the law of
6 a foreign country or possession of the United
7 States on an amount which does not constitute
8 income under United States tax principles shall
9 be treated as imposed on income described in
10 paragraph (1)(B).”

11 (6) Paragraph (2) of section 904(d) is amended
12 by adding at the end the following new subpara-
13 graph:

14 “(K) TRANSITIONAL RULES FOR 2005
15 CHANGES.—For purposes of paragraph (1)—

16 “(i) taxes carried from any taxable
17 year beginning before January 1, 2005, to
18 any taxable year beginning on or after
19 such date, with respect to any item of in-
20 come, shall be treated as described in the
21 subparagraph of paragraph (1) in which
22 such income would be described were such
23 taxes paid or accrued in a taxable year be-
24 ginning on or after such date, and



1 “(ii) the Secretary may by regulations
2 provide for the allocation of any carryback
3 of taxes with respect to income to such a
4 taxable year for purposes of allocating such
5 income among the separate categories in
6 effect for such taxable year.”.

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

10 (f) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to taxable years beginning after
12 December 31, 2004.

13 **SEC. 1084. LOOK-THRU RULES TO APPLY TO DIVIDENDS**
14 **FROM NONCONTROLLED SECTION 902 COR-**
15 **PORATIONS.**

16 (a) IN GENERAL.—Section 904(d)(4) (relating to
17 look-thru rules apply to dividends from noncontrolled sec-
18 tion 902 corporations) is amended to read as follows:

19 “(4) LOOK-THRU APPLIES TO DIVIDENDS FROM
20 NONCONTROLLED SECTION 902 CORPORATIONS.—

21 “(A) IN GENERAL.—For purposes of this
22 subsection, any dividend from a noncontrolled
23 section 902 corporation with respect to the tax-
24 payer shall be treated as income described in a



1 subparagraph of paragraph (1) in proportion to
2 the ratio of—

3 “(i) the portion of earnings and prof-
4 its attributable to income described in such
5 subparagraph, to

6 “(ii) the total amount of earnings and
7 profits.

8 “(B) SPECIAL RULES.—For purposes of
9 this paragraph—

10 “(i) EARNINGS AND PROFITS.—

11 “(I) IN GENERAL.—The rules of
12 section 316 shall apply.

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

20 “(ii) INADEQUATE SUBSTAN-
21 TIATION.—If the Secretary determines that
22 the proper subparagraph of paragraph (1)
23 in which a dividend is described has not
24 been substantiated, such dividend shall be



1 treated as income described in paragraph
2 (1)(A).

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

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

22 (b) CONFORMING AMENDMENTS.—

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

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



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

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

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

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

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

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

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



1 this paragraph, including rules to account for special
2 partnership allocations of dividends, credits, and
3 other incidents of ownership of stock in determining
4 proportionate ownership.”

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

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

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

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

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



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

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

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

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

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

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



1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years of foreign corpora-
3 tions beginning after December 31, 2004, and to taxable
4 years of United States shareholders with or within which
5 such taxable years of foreign corporations end.

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

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

15 “(D) ELECTIVE EXCEPTION FOR TAXES
16 PAID OTHER THAN IN FUNCTIONAL CUR-
17 RENCY.—

18 “(i) IN GENERAL.—At the election of
19 the taxpayer, subparagraph (A) shall not
20 apply to any foreign income taxes the li-
21 ability for which is denominated in any
22 currency other than in the taxpayer's func-
23 tional currency.

24 “(ii) APPLICATION TO QUALIFIED
25 BUSINESS UNITS.—An election under this



1 subparagraph may apply to foreign income
2 taxes attributable to a qualified business
3 unit in accordance with regulations pre-
4 scribed by the Secretary.

5 “(iii) ELECTION.—Any such election
6 shall apply to the taxable year for which
7 made and all subsequent taxable years un-
8 less revoked with the consent of the Sec-
9 retary.”

10 (b) EFFECTIVE DATE.—The amendment made by
11 this section shall apply to taxable years beginning after
12 December 31, 2004.

13 **SEC. 1089. REPEAL OF WITHHOLDING TAX ON DIVIDENDS**
14 **FROM CERTAIN FOREIGN CORPORATIONS.**

15 (a) IN GENERAL.—Paragraph (2) of section 871(i)
16 (relating to tax not to apply to certain interest and divi-
17 dends) is amended by adding at the end the following new
18 subparagraph:

19 “(D) Dividends paid by a foreign corpora-
20 tion which are treated under section
21 861(a)(2)(B) as income from sources within the
22 United States.”.

23 (b) EFFECTIVE DATE.—The amendment made by
24 this section shall apply to payments made after December
25 31, 2004.



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

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

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

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



1 **Subtitle I—Other Provisions**

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

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

7 (1) by striking “CONDITIONS.—For purposes”
8 and inserting “CONDITIONS.—

9 “(1) IN GENERAL.—For purposes”, and

10 (2) by adding at the end the following new
11 paragraph:

12 “(2) EXTENSION OF REPLACEMENT PERIOD.—

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

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



1 retary determines appropriate if the weather-re-
2 lated conditions which resulted in such applica-
3 tion continue for more than 3 years.”.

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

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

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

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

21 (a) IN GENERAL.—Subsection (a) of section 1388
22 (relating to patronage dividend defined) is amended by
23 adding at the end the following: “For purposes of para-
24 graph (3), net earnings shall not be reduced by amounts
25 paid during the year as dividends on capital stock or other



1 proprietary capital interests of the organization to the ex-
2 tent that the articles of incorporation or bylaws of such
3 organization or other contract with patrons provide that
4 such dividends are in addition to amounts otherwise pay-
5 able to patrons which are derived from business done with
6 or for patrons during the taxable year.”.

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

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

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

17 “(I) Any vaccine against hepatitis A.”

18 (b) EFFECTIVE DATE.—

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

24 (2) DELIVERIES.—For purposes of paragraph
25 (1) and section 4131 of the Internal Revenue Code



1 of 1986, in the case of sales on or before the effective
2 tive date described in such paragraph for which delivery
3 is made after such date, the delivery date shall
4 be considered the sale date.

5 **SEC. 1104. EXPANSION OF HUMAN CLINICAL TRIALS QUALIFYING FOR ORPHAN DRUG CREDIT.**
6

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

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

21 (b) EFFECTIVE DATE.—The amendment made by
22 subsection (a) shall apply to expenses incurred after the
23 date of the enactment of this Act.



1 **SEC. 1105. TREATMENT OF DISTRIBUTIONS FROM PUB-**
2 **LICLY TRADED PARTNERSHIPS TO REGU-**
3 **LATED INVESTMENT COMPANIES.**

4 (a) IN GENERAL.—Paragraph (2) of section 851(b)
5 (defining regulated investment company) is amended by
6 inserting “distributions or other income derived from an
7 interest in a publicly traded partnership (as defined in sec-
8 tion 7704(b)),” after “dividends, interest,”.

9 (b) SOURCE FLOW-THROUGH RULE NOT TO
10 APPLY.—The last sentence of section 851(b) is amended
11 by inserting “(other than a publicly traded partnership (as
12 defined in section 7704(b)))” after “derived from a part-
13 nership”.

14 (c) LIMITATION ON OWNERSHIP.—Subsection (c) of
15 section 851 is amended by redesignating paragraph (5)
16 as paragraph (6) and inserting after paragraph (4) the
17 following new paragraph:

18 “(5) The term ‘outstanding voting securities of
19 such issuer’ shall include the equity securities of a
20 publicly traded partnership (as defined in section
21 7704(b)).”.

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

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



1 “(i) the securities (other than Govern-
2 ment securities or the securities of other
3 regulated investment companies) of any
4 one issuer,

5 “(ii) the securities (other than the se-
6 curities of other regulated investment com-
7 panies) of two or more issuers which the
8 taxpayer controls and which are deter-
9 mined, under regulations prescribed by the
10 Secretary, to be engaged in the same or
11 similar trades or businesses or related
12 trades or businesses, or

13 “(iii) the securities of one or more
14 publicly traded partnerships (as defined in
15 section 7704(b)).”.

16 (e) APPLICATION OF SPECIAL PASSIVE ACTIVITY
17 RULE TO REGULATED INVESTMENT COMPANIES.—Sub-
18 section (k) of section 469 (relating to separate application
19 of section in case of publicly traded partnerships) is
20 amended by adding at the end the following new para-
21 graph:

22 “(4) APPLICATION TO REGULATED INVEST-
23 MENT COMPANIES.—For purposes of this section, a
24 regulated investment company (as defined in section
25 851) holding an interest in a publicly traded part-



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

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

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

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

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

20 “(G) Any other arrangement as deter-
21 mined by the Secretary.

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

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



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

4 “(B) SPECIAL RULES RELATING TO CER-
5 TAIN CONTINGENCIES.—For purposes of sub-
6 paragraph (A), any interest or principal shall
7 not be treated as failing to satisfy section
8 1361(c)(5)(B)(i) solely by reason of the fact
9 that the time of payment of such interest or
10 principal is subject to a contingency, but only
11 if—

12 “(i) any such contingency does not
13 have the effect of changing the effective
14 yield to maturity, as determined under sec-
15 tion 1272, other than a change in the an-
16 nual yield to maturity which either—

17 “(I) does not exceed the greater
18 of $\frac{1}{4}$ of 1 percent or 5 percent of the
19 annual yield to maturity, or

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

23 “(ii) neither the aggregate issue price
24 nor the aggregate face amount of the
25 issuer’s debt instruments held by the trust



1 exceeds \$1,000,000 and not more than 12
2 months of unaccrued interest can be re-
3 quired to be prepaid thereunder.

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

14 “(i) are not described in paragraph
15 (1) (prior to the application of this sub-
16 paragraph), and

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

21 “(3) LOOK-THROUGH RULE FOR PARTNERSHIP
22 SECURITIES.—

23 “(A) IN GENERAL.—For purposes of ap-
24 plying subclause (III) of subsection
25 (c)(4)(B)(iii)—



1 “(i) a trust’s interest as a partner in
2 a partnership (as defined in section
3 7701(a)(2)) shall not be considered a secu-
4 rity, and

5 “(ii) the trust shall be deemed to own
6 its proportionate share of each of the as-
7 sets of the partnership.

8 “(B) DETERMINATION OF TRUST’S INTER-
9 EST IN PARTNERSHIP ASSETS.—For purposes
10 of subparagraph (A), with respect to any tax-
11 able year beginning after the date of the enact-
12 ment of this subparagraph—

13 “(i) the trust’s interest in the partner-
14 ship assets shall be the trust’s propor-
15 tionate interest in any securities issued by
16 the partnership (determined without re-
17 gard to subparagraph (A)(i) and para-
18 graph (4), but not including securities de-
19 scribed in paragraph (1)), and

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

23 “(4) CERTAIN PARTNERSHIP DEBT INSTRU-
24 MENTS NOT TREATED AS A SECURITY.—For pur-



1 poses of applying subclause (III) of subsection
2 (c)(4)(B)(iii)—

3 “(A) any debt instrument issued by a part-
4 nership and not described in paragraph (1)
5 shall not be considered a security to the extent
6 of the trust’s interest as a partner in the part-
7 nership, and

8 “(B) any debt instrument issued by a part-
9 nership and not described in paragraph (1)
10 shall not be considered a security if at least 75
11 percent of the partnership’s gross income (ex-
12 cluding gross income from prohibited trans-
13 actions) is derived from sources referred to in
14 subsection (c)(3).

15 “(5) SECRETARIAL GUIDANCE.—The Secretary
16 is authorized to provide guidance (including through
17 the issuance of a written determination, as defined
18 in section 6110(b)) that an arrangement shall not be
19 considered a security held by the trust for purposes
20 of applying subclause (III) of subsection
21 (c)(4)(B)(iii) notwithstanding that such arrangement
22 otherwise could be considered a security under sub-
23 paragraph (F) of subsection (e)(5).”.

24 (b) CLARIFICATION OF APPLICATION OF LIMITED
25 RENTAL EXCEPTION.—Subparagraph (A) of section



1 856(d)(8) (relating to special rules for taxable REIT sub-
2 sidiaries) is amended to read as follows:

3 “(A) LIMITED RENTAL EXCEPTION.—

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

11 “(ii) RENTS MUST BE SUBSTANTIALLY
12 COMPARABLE.—Clause (i) shall apply only
13 to the extent that the amounts paid to the
14 trust as rents from real property (as de-
15 fined in paragraph (1) without regard to
16 paragraph (2)(B)) from such property are
17 substantially comparable to such rents paid
18 by the other tenants of the trust’s property
19 for comparable space.

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



1 if such requirement is met under the terms
2 of the lease—

3 “(I) at the time such lease is en-
4 tered into,

5 “(II) at the time of each exten-
6 sion of the lease, including a failure to
7 exercise a right to terminate, and

8 “(III) at the time of any modi-
9 fication of the lease between the trust
10 and the taxable REIT subsidiary if
11 the rent under such lease is effectively
12 increased pursuant to such modifica-
13 tion.

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

21 “(iv) CONTROLLED TAXABLE REIT
22 SUBSIDIARY.—For purposes of clause (iii),
23 the term ‘controlled taxable REIT sub-
24 sidiary’ means, with respect to any real es-
25 tate investment trust, any taxable REIT



1 subsidiary of such trust if such trust owns
2 directly or indirectly—

3 “(I) stock possessing more than
4 50 percent of the total voting power
5 of the outstanding stock of such sub-
6 sidiary, or

7 “(II) stock having a value of
8 more than 50 percent of the total
9 value of the outstanding stock of such
10 subsidiary.

11 “(v) CONTINUING QUALIFICATION
12 BASED ON THIRD PARTY ACTIONS.—If the
13 requirements of clause (i) are met at a
14 time referred to in clause (iii), such re-
15 quirements shall continue to be treated as
16 met so long as there is no increase in the
17 space leased to any taxable REIT sub-
18 sidiary of such trust or to any person de-
19 scribed in paragraph (2)(B).

20 “(vi) CORRECTION PERIOD.—If there
21 is an increase referred to in clause (v) dur-
22 ing any calendar quarter with respect to
23 any property, the requirements of clause
24 (iii) shall be treated as met during the
25 quarter and the succeeding quarter if such



1 requirements are met at the close of such
2 succeeding quarter.”.

3 (c) DELETION OF CUSTOMARY SERVICES EXCEP-
4 TION.—Subparagraph (B) of section 857(b)(7) (relating
5 to redetermined rents) is amended by striking clause (ii)
6 and by redesignating clauses (iii), (iv), (v), (vi), and (vii)
7 as clauses (ii), (iii), (iv), (v), and (vi), respectively.

8 (d) CONFORMITY WITH GENERAL HEDGING DEFINI-
9 TION.—Subparagraph (G) of section 856(c)(5) (relating
10 to treatment of certain hedging instruments) is amended
11 to read as follows:

12 “(G) TREATMENT OF CERTAIN HEDGING
13 INSTRUMENTS.—Except to the extent provided
14 by regulations, any income of a real estate in-
15 vestment trust from a hedging transaction (as
16 defined in clause (ii) or (iii) of section
17 1221(b)(2)(A)) which is clearly identified pur-
18 suant to section 1221(a)(7), including gain
19 from the sale or disposition of such a trans-
20 action, shall not constitute gross income under
21 paragraph (2) to the extent that the transaction
22 hedges any indebtedness incurred or to be in-
23 curred by the trust to acquire or carry real es-
24 tate assets.”.



1 (e) CONFORMITY WITH REGULATED INVESTMENT
2 COMPANY RULES.—Clause (i) of section 857(b)(5)(A) (re-
3 lating to imposition of tax in case of failure to meet certain
4 requirements) is amended by striking “90 percent” and
5 inserting “95 percent”.

6 (f) EFFECTIVE DATES.—

7 (1) IN GENERAL.—Except as provided in para-
8 graph (2), the amendments made by this section
9 shall apply to taxable years beginning after Decem-
10 ber 31, 2000.

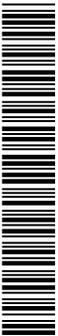
11 (2) SUBPARAGRAPHS (c) THROUGH (e).—The
12 amendments made by subsections (c), (d), and (e)
13 shall apply to taxable years beginning after the date
14 of the enactment of this Act.

15 **SEC. 1107. SIMPLIFICATION OF EXCISE TAX IMPOSED ON**
16 **BOWS AND ARROWS.**

17 (a) BOWS.—Paragraph (1) of section 4161(b) (relat-
18 ing to bows) is amended to read as follows:

19 “(1) BOWS.—

20 “(A) IN GENERAL.—There is hereby im-
21 posed on the sale by the manufacturer, pro-
22 ducer, or importer of any bow which has a peak
23 draw weight of 30 pounds or more, a tax equal
24 to 11 percent of the price for which so sold.



1 “(B) ARCHERY EQUIPMENT.—There is
2 hereby imposed on the sale by the manufac-
3 turer, producer, or importer—

4 “(i) of any part or accessory suitable
5 for inclusion in or attachment to a bow de-
6 scribed in subparagraph (A), and

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

12 (b) ARROWS.—Subsection (b) of section 4161 (relat-
13 ing to bows and arrows, etc.) is amended by redesignating
14 paragraph (3) as paragraph (4) and inserting after para-
15 graph (2) the following:

16 “(3) ARROWS.—

17 “(A) IN GENERAL.—There is hereby im-
18 posed on the sale by the manufacturer, pro-
19 ducer, or importer of any arrow, a tax equal to
20 12 percent of the price for which so sold.

21 “(B) EXCEPTION.—The tax imposed by
22 subparagraph (A) on an arrow shall not apply
23 if the arrow contains an arrow shaft with re-
24 spect to which tax was imposed under para-
25 graph (2).



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

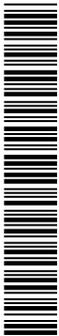
5 (c) CONFORMING AMENDMENT.—The heading of sec-
6 tion 4161(b)(2) is amended by striking “ARROWS.—” and
7 inserting “ARROW COMPONENTS.—”.

8 (d) EFFECTIVE DATE.—The amendments made by
9 this section shall apply to articles sold by the manufac-
10 turer, producer, or importer after December 31, 2003.

11 **SEC. 1108. REPEAL OF EXCISE TAX ON FISHING TACKLE**
12 **BOXES.**

13 (a) REPEAL.—Paragraph (6) of section 4162(a) (de-
14 fining sport fishing equipment) is amended by striking
15 subparagraph (C) and by redesignating subparagraphs
16 (D) through (J) as subparagraphs (C) through (I), respec-
17 tively.

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



1 **SEC. 1109. INCOME TAX CREDIT TO DISTILLED SPIRITS**
2 **WHOLESALEERS FOR COST OF CARRYING FED-**
3 **ERAL EXCISE TAXES ON BOTTLED DISTILLED**
4 **SPIRITS.**

5 (a) IN GENERAL.—Subpart A of part I of subchapter
6 A of chapter 51 (relating to gallonage and occupational
7 taxes) is amended by adding at the end the following new
8 section:

9 **“SEC. 5011. INCOME TAX CREDIT FOR WHOLESALER’S AV-**
10 **ERAGE COST OF CARRYING EXCISE TAX.**

11 “(a) IN GENERAL.—For purposes of section 38, in
12 the case of an eligible wholesaler, the amount of the dis-
13 tilled spirits wholesalers credit for any taxable year is the
14 amount equal to the product of—

15 “(1) the number of cases of bottled distilled
16 spirits—

17 “(A) which were bottled in the United
18 States, and

19 “(B) which are purchased by such whole-
20 saler during the taxable year directly from the
21 bottler of such spirits, and

22 “(2) the average tax-financing cost per case for
23 the most recent calendar year ending before the be-
24 ginning of such taxable year.

25 “(b) ELIGIBLE WHOLESALER.—For purposes of this
26 section, the term ‘eligible wholesaler’ means any person



1 who holds a permit under the Federal Alcohol Administra-
2 tion Act as a wholesaler of distilled spirits.

3 “(c) AVERAGE TAX-FINANCING COST.—

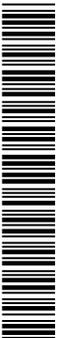
4 “(1) IN GENERAL.—For purposes of this sec-
5 tion, the average tax-financing cost per case for any
6 calendar year is the amount of interest which would
7 accrue at the deemed financing rate during a 60-day
8 period on an amount equal to the deemed Federal
9 excise per case.

10 “(2) DEEMED FINANCING RATE.—For purposes
11 of paragraph (1), the deemed financing rate for any
12 calendar year is the average of the corporate over-
13 payment rates under paragraph (1) of section
14 6621(a) (determined without regard to the last sen-
15 tence of such paragraph) for calendar quarters of
16 such year.

17 “(3) DEEMED FEDERAL EXCISE TAX BASED ON
18 CASE OF 12 80-PROOF 750ML BOTTLES.—For pur-
19 poses of paragraph (1), the deemed Federal excise
20 tax per case is \$22.83.

21 “(4) NUMBER OF CASES IN LOT.—For purposes
22 of this section, the number of cases in any lot of dis-
23 tilled spirits shall be determined by dividing the
24 number of liters in such lot by 9.”

25 (b) CONFORMING AMENDMENTS.—



1 (1) Subsection (b) of section 38 is amended by
2 striking “plus” at the end of paragraph (14), by
3 striking the period at the end of paragraph (15) and
4 inserting “, plus”, and by adding at the end the fol-
5 lowing new paragraph:

6 “(16) in the case of an eligible wholesaler (as
7 defined in section 5011(b)), the distilled spirits
8 wholesaler credit determined under section
9 5011(a).”

10 (2) Subsection (d) of section 39 (relating to
11 carryback and carryforward of unused credits) is
12 amended by adding at the end the following new
13 paragraph:

14 “(11) NO CARRYBACK OF SECTION 5011 CREDIT
15 BEFORE JANUARY 1, 2004.—No portion of the un-
16 used business credit for any taxable year which is
17 attributable to the credit determined under section
18 5011(a) may be carried back to a taxable year be-
19 ginning before January 1, 2004.”.

20 (3) The table of sections for subpart A of part
21 I of subchapter A of chapter 51 is amended by add-
22 ing at the end the following new item:

 “Sec. 5011. Income tax credit for wholesaler’s average cost of car-
 rying excise tax.”.



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

4 **SEC. 1110. CAPITAL GAIN TREATMENT UNDER SECTION**
5 **631(b) TO APPLY TO OUTRIGHT SALES BY**
6 **LANDOWNERS.**

7 (a) IN GENERAL.—The first sentence of section
8 631(b) (relating to disposal of timber with a retained eco-
9 nomic interest) is amended by striking “retains an eco-
10 nomic interest in such timber” and inserting “either re-
11 tains an economic interest in such timber or makes an
12 outright sale of such timber”.

13 (b) CONFORMING AMENDMENTS.—

14 (1) The third sentence of section 631(b) is
15 amended by striking “The date of disposal” and in-
16 serting “In the case of disposal of timber with a re-
17 tained economic interest, the date of disposal”.

18 (2) The heading for section 631(b) is amended
19 by striking “WITH A RETAINED ECONOMIC INTER-
20 EST”.

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to sales after December 31, 2003.

23 **SEC. 1111. SONAR DEVICES SUITABLE FOR FINDING FISH.**

24 (a) NOT TREATED AS SPORT FISHING EQUIP-
25 MENT.—Subsection (a) of section 4162 (relating to sport



1 fishing equipment defined) is amended by inserting “and”
2 at the end of paragraph (8), by striking “, and” at the
3 end of paragraph (9) and inserting a period, and by strik-
4 ing paragraph (10).

5 (b) CONFORMING AMENDMENT.—Section 4162 is
6 amended by striking subsection (b) and by redesignating
7 subsection (c) as subsection (b).

8 (c) EFFECTIVE DATE.—The amendments made this
9 section shall apply to articles sold by the manufacturer,
10 producer, or importer after December 31, 2003.

11 **SEC. 1112. TAXATION OF CERTAIN SETTLEMENT FUNDS.**

12 (a) IN GENERAL.—Subsection (g) of section 468B
13 (relating to clarification of taxation of certain funds) is
14 amended to read as follows:

15 “(g) CLARIFICATION OF TAXATION OF CERTAIN
16 FUNDS.—

17 “(1) IN GENERAL.—Except as provided in para-
18 graph (2), nothing in any provision of law shall be
19 construed as providing that an escrow account, set-
20 tlement fund, or similar fund is not subject to cur-
21 rent income tax. The Secretary shall prescribe regu-
22 lations providing for the taxation of any such ac-
23 count or fund whether as a grantor trust or other-
24 wise.



1 “(2) EXEMPTION FROM TAX FOR CERTAIN SET-
2 TLEMENT FUNDS.—An escrow account, settlement
3 fund, or similar fund shall be treated as beneficially
4 owned by the United States and shall be exempt
5 from taxation under this subtitle if—

6 “(A) it is established pursuant to a con-
7 sent decree entered by a judge of a United
8 States District Court,

9 “(B) it is created for the receipt of settle-
10 ment payments as directed by a government en-
11 tity for the sole purpose of resolving or satis-
12 fying one or more claims asserting liability
13 under the Comprehensive Environmental Re-
14 sponse, Compensation, and Liability Act of
15 1980,

16 “(C) the authority and control over the ex-
17 penditure of funds therein (including the ex-
18 penditure of contributions thereto and any net
19 earnings thereon) is with such government enti-
20 ty, and

21 “(D) upon termination, any remaining
22 funds will be disbursed upon instructions by
23 such government entity in accordance with ap-
24 plicable law.



1 For purposes of this paragraph, the term ‘govern-
2 ment entity’ means the United States, any State or
3 political subdivision thereof, the District of Colum-
4 bia, any possession of the United States, and any
5 agency or instrumentality of any of the foregoing.”.

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

9 **SEC. 1113. SUSPENSION OF OCCUPATIONAL TAXES RELAT-**
10 **ING TO DISTILLED SPIRITS, WINE, AND BEER.**

11 (a) IN GENERAL.—Subpart G of part II of sub-
12 chapter A of chapter 51 is amended by redesignating sec-
13 tion 5148 as section 5149 and by inserting after section
14 5147 the following new section:

15 **“SEC. 5148. SUSPENSION OF OCCUPATIONAL TAX.**

16 “(a) IN GENERAL.—Notwithstanding sections 5081,
17 5091, 5111, 5121, and 5131, the rate of tax imposed
18 under such sections for the suspension period shall be
19 zero. During such period, persons engaged in or carrying
20 on a trade or business covered by such sections shall reg-
21 ister under section 5141 and shall comply with the record-
22 keeping requirements under this part.

23 “(b) SUSPENSION PERIOD.—For purposes of sub-
24 section (a), the suspension period is the period beginning
25 on July 1, 2004, and ending on June 30, 2007.”.



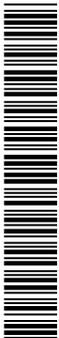
1 (b) CONFORMING AMENDMENT.—Section 5117 is
2 amended by adding at the end the following new sub-
3 section:

4 “(d) SPECIAL RULE DURING SUSPENSION PE-
5 RIOD.—Except as provided by the Secretary, during the
6 suspension period (as defined in section 5148) it shall be
7 unlawful for any dealer to purchase distilled spirits for re-
8 sale from any person other than a wholesale dealer in liq-
9 uors who is required to keep records under section 5114.”.

10 (c) CLERICAL AMENDMENT.—The table of sections
11 for subpart G of part II of subchapter A of chapter 51
12 is amended by striking the last item and inserting the fol-
13 lowing new items:

“Sec. 5148. Suspension of occupational tax.
“Sec. 5149. Cross references.”.

14 (d) EFFECTIVE DATE.—The amendments made by
15 this section shall take effect on the date of the enactment
16 of this Act.



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

6 **SEC. 2001. REDUCTION IN POTENTIAL FOR EARNINGS**
 7 **STRIPPING BY FURTHER LIMITING DEDUC-**
 8 **TION FOR INTEREST ON CERTAIN INDEBTED-**
 9 **NESS.**

10 (a) REDUCTION IN POTENTIAL FOR EARNINGS
 11 STRIPPING.—Paragraphs (1) and (2) of section 163(j) are
 12 amended to read as follows:

13 “(1) LIMITATION.—

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

18 “(B) MAXIMUM DISALLOWANCE.—The
 19 amount disallowed under subparagraph (A)
 20 shall not exceed the sum of—

21 “(i) the corporation’s excess interest
 22 expense for the taxable year, and

23 “(ii) the corporation’s excess related
 24 party interest expense for such year.



1 In no event shall the disallowance under sub-
2 paragraph (A) reduce the deduction for interest
3 below the sum of the amount of interest includ-
4 ible in the gross income of the taxpayer for
5 such taxable year and an amount equal to 25
6 percent of adjusted taxable income (35 percent
7 in the case of the first taxable year beginning
8 after December 31, 2003).

9 “(C) DISALLOWED AMOUNT CARRIED TO
10 SUCCEEDING TAXABLE YEAR.—

11 “(i) IN GENERAL.—Any amount dis-
12 allowed under subparagraph (A) for any
13 taxable year shall be treated as paid or ac-
14 crued in the succeeding taxable year and in
15 the 2nd through 10th succeeding taxable
16 years to the extent not previously taken
17 into account under this subparagraph.

18 “(ii) LIMITATION ON AMOUNT CAR-
19 RIED TO YEAR.—A carryforward amount
20 may not be taken into account for any
21 such succeeding taxable year to the extent
22 that such amount, when added to amounts
23 carried to such succeeding taxable year
24 from taxable years preceding the taxable
25 year from which the amount is being car-



1 ried forward, would result in (or increase)
2 a disallowance under subparagraph (A).

3 “(iii) CARRYOVER APPLIED SEPA-
4 RATELY TO CATEGORIES OF DISQUALIFIED
5 INTEREST.—Clauses (i) and (ii) shall be
6 applied separately to disqualified interest
7 described in paragraph (3)(A) and to dis-
8 qualified interest described in paragraph
9 (3)(B). For purposes of this subparagraph,
10 any amount disallowed under subpara-
11 graph (A) for any taxable year shall be
12 treated as disqualified interest described in
13 paragraph (3)(A) to the extent thereof and
14 then as disqualified interest described in
15 paragraph (3)(B).

16 “(2) EXCESS INTEREST EXPENSE; EXCESS RE-
17 LATED PARTY INTEREST EXPENSE.—For purposes
18 of this subsection—

19 “(A) EXCESS INTEREST EXPENSE.—The
20 term ‘excess interest expense’ means the excess
21 (if any) of—

22 “(i) the corporation’s net interest ex-
23 pense, over

24 “(ii) 50 percent of the adjusted tax-
25 able income of the corporation.



1 “(B) EXCESS RELATED PARTY INTEREST
2 EXPENSE.—The term ‘excess related party in-
3 terest expense’ means the excess (if any) of—

4 “(i) the lesser of—

5 “(I) the amount of disqualified
6 interest described in paragraph
7 (3)(A), or

8 “(II) the corporation’s net inter-
9 est expense, over

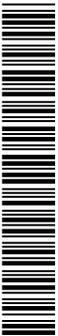
10 “(ii) 25 percent (35 percent in the
11 case of the first taxable year beginning
12 after December 31, 2003) of the adjusted
13 taxable income of the corporation.

14 “(3) ALTERNATIVE MAXIMUM DISALLOW-
15 ANCE.—

16 “(A) IN GENERAL.—In the case of a cor-
17 poration with respect to which an election is in
18 effect under subparagraph (B), the amount dis-
19 allowed under paragraph (1)(A) shall not ex-
20 ceed the excess (if any) of—

21 “(i) the corporation’s net interest ex-
22 pense, over

23 “(ii) 30 percent of the adjusted tax-
24 able income of the corporation.



1 “(B) ELECTION.—A corporation may
2 make a one-time irrevocable election to have the
3 alternative maximum disallowance described in
4 subparagraph (A) apply for purposes of this
5 subsection in lieu of paragraph (1)(B). An elec-
6 tion under this subparagraph shall not apply
7 with respect to any taxable year beginning be-
8 fore January 1, 2005.

9 “(C) LIMITATION.—Subparagraph (B)
10 shall not apply with respect to any corporation
11 which is—

12 “(i) a surrogate foreign corporation
13 (as defined in section 7874(a)(2)(B)),

14 “(ii) a corporation which would be a
15 surrogate foreign corporation (as so de-
16 fined) if “December 31, 1996” were sub-
17 stituted for “March 4, 2003” in section
18 7874(a), or

19 “(iii) a corporation which is an expa-
20 triated entity (as defined in section
21 7874(a)) with respect to a corporation de-
22 scribed in clause (i) or (ii).”.

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



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

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

8 “(m) LIMITATION ON DEDUCTION FOR INTEREST ON
9 CERTAIN INDEBTEDNESS OF TAXABLE REIT SUB-
10 SIDIARY.—

11 “(1) LIMITATION.—

12 “(A) IN GENERAL.—If this subsection ap-
13 plies to any taxable REIT subsidiary for any
14 taxable year, no deduction shall be allowed
15 under this chapter for disqualified interest paid
16 or accrued by such subsidiary during such tax-
17 able year. The amount disallowed under the
18 preceding sentence shall not exceed the subsidi-
19 ary’s excess interest expense for the taxable
20 year.

21 “(B) DISALLOWED AMOUNT CARRIED TO
22 SUCCEEDING TAXABLE YEAR.—Any amount dis-
23 allowed under subparagraph (A) for any taxable
24 year shall be treated as disqualified interest
25 paid or accrued in the succeeding taxable year



1 (and clause (ii) of paragraph (2)(A) shall not
2 apply for purposes of applying this subsection
3 to the amount so treated).

4 “(2) SUBSIDIARIES TO WHICH SUBSECTION AP-
5 PLIES.—

6 “(A) IN GENERAL.—This subsection shall
7 apply to any taxable REIT subsidiary for any
8 taxable year if—

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

11 “(ii) the ratio of debt to equity of
12 such subsidiary as of the close of such tax-
13 able year (or on any other day during the
14 taxable year as the Secretary may by regu-
15 lations prescribe) exceeds 1.5 to 1.

16 “(B) EXCESS INTEREST EXPENSE.—

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

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

22 “(II) the sum of 50 percent of
23 the adjusted taxable income of the
24 subsidiary plus any excess limitation
25 carryforward under clause (ii).



1 “(ii) EXCESS LIMITATION
2 CARRYFORWARD.—If a taxable REIT sub-
3 sidiary has an excess limitation for any
4 taxable year, the amount of such excess
5 limitation shall be an excess limitation
6 carryforward to the 1st succeeding taxable
7 year and to the 2nd and 3rd succeeding
8 taxable years to the extent not previously
9 taken into account under this clause. The
10 amount of such a carryforward taken into
11 account for any such succeeding taxable
12 year shall not exceed the excess interest
13 expense for such succeeding taxable year
14 (determined without regard to the
15 carryforward from the taxable year of such
16 excess limitation).

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

20 “(I) 50 percent of the adjusted
21 taxable income of the subsidiary, over

22 “(II) the subsidiary’s net interest
23 expense.

24 “(C) RATIO OF DEBT TO EQUITY.—For
25 purposes of this paragraph, the term ‘ratio of



1 debt to equity’ means the ratio which the total
2 indebtedness of the subsidiary bears to the sum
3 of its money and all other assets reduced (but
4 not below zero) by such total indebtedness. The
5 rules of section 163(j)(6)(E) shall apply for
6 purposes of the preceding sentence.

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

12 “(4) OTHER RULES TO APPLY.—Rules similar
13 to the rules of paragraphs (7), (8), and (9) of sec-
14 tion 163(j) shall apply for purposes of this sub-
15 section.”

16 (c) EFFECTIVE DATE.—

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

21 (2) EARLIER EFFECTIVE DATE WITH RESPECT
22 TO EXPATRIATED CORPORATIONS, ETC.—The
23 amendments made by this section shall apply to tax-
24 able years ending after March 4, 2003, in the case
25 of a taxpayer which is—



1 (A) a surrogate foreign corporation, as de-
2 fined in section 7874(a)(2)(B) of the Internal
3 Revenue Code of 1986, as added by section
4 2002,

5 (B) a corporation which would be a surro-
6 gate foreign corporation (as so defined) if “De-
7 cember 31, 1996” were substituted for “March
8 4, 2003” in such section 7874(a), or

9 (C) a corporation which is an expatriated
10 entity (as defined in such section 7874(a)) with
11 respect to a corporation described in subpara-
12 graph (A) or (B).

13 In applying such amendments to a taxpayer de-
14 scribed in the preceding sentence, subparagraph (B)
15 of section 163(j)(2) of such Code, as amended by
16 this section, shall be applied by substituting “25
17 percent” for “35 percent”.

18 (3) LIMITATION ON CARRYOVER OF DIS-
19 ALLOWED INTEREST.—

20 (A) IN GENERAL.—Except in the case of a
21 taxpayer described in paragraph (2), for pur-
22 poses of applying section 163(j)(1)(C) of the
23 Internal Revenue Code of 1986 (as added by
24 this section), amounts carried from a taxable
25 year beginning before January 1, 2004, to any



1 taxable year beginning after December 31,
2 2003, shall be treated as disqualified interest
3 described in section 163(j)(3)(B) of such Code
4 which is disallowed for the most recent taxable
5 year beginning before January 1, 2004.

6 (B) EXPATRIATED CORPORATIONS.—In the
7 case of a taxpayer described in paragraph (2),
8 a rule similar to the rule of subparagraph (A)
9 shall apply to amounts carried from a taxable
10 year ending on or before March 5, 2003.

11 **SEC. 2002. TAX TREATMENT OF EXPATRIATED ENTITIES**
12 **AND THEIR FOREIGN PARENTS.**

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

16 **“SEC. 7874. RULES RELATING TO EXPATRIATED ENTITIES**
17 **AND THEIR FOREIGN PARENTS.**

18 “(a) TAX ON INVERSION GAIN OF EXPATRIATED EN-
19 TITIES.—

20 “(1) IN GENERAL.—The taxable income of an
21 expatriated entity for any taxable year which in-
22 cludes any portion of the applicable period shall in
23 no event be less than the inversion gain of the entity
24 for the taxable year.



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

3 “(A) IN GENERAL.—The term ‘expatriated
4 entity’ means—

5 “(i) the domestic corporation or part-
6 nership referred to in subparagraph (B)(i)
7 with respect to which a foreign corporation
8 is a surrogate foreign corporation, and

9 “(ii) any United States person who is
10 related (within the meaning of section
11 267(b) or 707(b)(1)) to a domestic cor-
12 poration or partnership described in clause
13 (i).

14 “(B) SURROGATE FOREIGN CORPORA-
15 TION.—A foreign corporation shall be treated
16 as a surrogate foreign corporation if, pursuant
17 to a plan (or a series of related transactions)—

18 “(i) the entity completes after March
19 4, 2003, the direct or indirect acquisition
20 of substantially all of the properties held
21 directly or indirectly by a domestic cor-
22 poration or substantially all of the prop-
23 erties constituting a trade or business of a
24 domestic partnership,



1 “(ii) after the acquisition at least 60
2 percent of the stock (by vote or value) of
3 the entity is held—

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

10 “(II) in the case of an acquisition
11 with respect to a domestic partner-
12 ship, by former partners of the do-
13 mestic partnership by reason of hold-
14 ing a capital or profits interest in the
15 domestic partnership, and

16 “(iii) after the acquisition the ex-
17 panded affiliated group which includes the
18 entity does not have substantial business
19 activities in the foreign country in which,
20 or under the law of which, the entity is
21 created or organized, when compared to
22 the total business activities of such ex-
23 panded affiliated group.

24 An entity otherwise described in clause (i) with
25 respect to any domestic corporation or partner-



1 ship trade or business shall be treated as not so
2 described if, on or before March 4, 2003, such
3 entity acquired directly or indirectly more than
4 half of the properties held directly or indirectly
5 by such corporation or more than half of the
6 properties constituting such partnership trade
7 or business, as the case may be.

8 “(b) DEFINITIONS AND SPECIAL RULES.—

9 “(1) EXPANDED AFFILIATED GROUP.—The
10 term ‘expanded affiliated group’ means an affiliated
11 group as defined in section 1504(a) but without re-
12 gard to section 1504(b)(3), except that section
13 1504(a) shall be applied by substituting ‘more than
14 50 percent’ for ‘at least 80 percent’ each place it ap-
15 pears.

16 “(2) CERTAIN STOCK DISREGARDED.—There
17 shall not be taken into account in determining own-
18 ership under subsection (a)(2)(B)(ii)—

19 “(A) stock held by members of the ex-
20 panded affiliated group which includes the for-
21 eign corporation, or

22 “(B) stock of such foreign corporation
23 which is sold in a public offering related to the
24 acquisition described in subsection (a)(2)(B)(i).



1 “(3) PLAN DEEMED IN CERTAIN CASES.—If a
2 foreign corporation acquires directly or indirectly
3 substantially all of the properties of a domestic cor-
4 poration or partnership during the 4-year period be-
5 ginning on the date which is 2 years before the own-
6 ership requirements of subsection (a)(2)(B)(ii) are
7 met, such actions shall be treated as pursuant to a
8 plan.

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

14 “(5) SPECIAL RULE FOR RELATED PARTNER-
15 SHIPS.—For purposes of applying subsection
16 (a)(2)(B)(ii) to the acquisition of a trade or business
17 of a domestic partnership, except as provided in reg-
18 ulations, all partnerships which are under common
19 control (within the meaning of section 482) shall be
20 treated as 1 partnership.

21 “(6) REGULATIONS.—The Secretary shall pre-
22 scribe such regulations as may be appropriate to de-
23 termine whether a corporation is a surrogate foreign
24 corporation, including regulations—



1 “(A) to treat warrants, options, contracts
2 to acquire stock, convertible debt interests, and
3 other similar interests as stock, and

4 “(B) to treat stock as not stock.

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

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

9 “(A) beginning on the first date properties
10 are acquired as part of the acquisition described
11 in subsection (a)(2)(B)(i), and

12 “(B) ending on the date which is 10 years
13 after the last date properties are acquired as
14 part of such acquisition.

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

22 “(A) as part of the acquisition described in
23 subsection (a)(2)(B)(i), or

24 “(B) after such acquisition if the transfer
25 or license is to a foreign related person.



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

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

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

9 “(B) is under the same common control
10 (within the meaning of section 482) as such en-
11 tity.

12 “(d) SPECIAL RULES.—

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

19 “(A) the amount of the inversion gain for
20 the taxable year, and

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

23 For purposes of determining the credit allowed by
24 section 901, inversion gain shall be treated as from
25 sources within the United States.



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

4 “(A) subsection (a)(1) shall apply at the
5 partner rather than the partnership level,

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

8 “(i) the partner’s distributive share of
9 inversion gain of the partnership for such
10 taxable year, plus

11 “(ii) gain recognized for the taxable
12 year by the partner by reason of the trans-
13 fer during the applicable period of any
14 partnership interest of the partner in such
15 partnership to the surrogate foreign cor-
16 poration, and

17 “(C) the highest rate of tax specified in
18 the rate schedule applicable to the partner
19 under this chapter shall be substituted for the
20 rate of tax referred to in paragraph (1).

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

25 “(4) STATUTE OF LIMITATIONS.—



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

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

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

19 “(ii) such year ends before the taxable
20 year in which the acquisition described in
21 subsection (a)(2)(B)(i) is completed.

22 “(f) SPECIAL RULE FOR TREATIES.—Nothing in sec-
23 tion 894 or 7852(d) or in any other provision of law shall
24 be construed as permitting an exemption, by reason of any



1 treaty obligation of the United States heretofore or here-
2 after entered into, from the provisions of this section.

3 “(g) 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) CONFORMING AMENDMENT.—The table of sec-
16 tions for subchapter C of chapter 80 is amended by adding
17 at the end the following new item:

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

18 (c) EFFECTIVE DATE.—The amendments made by
19 this section shall apply to taxable years ending after
20 March 4, 2003.

21 **SEC. 2003. EXCISE TAX ON STOCK COMPENSATION OF IN-**
22 **SIDERS IN EXPATRIATED CORPORATIONS.**

23 (a) IN GENERAL.—Subtitle D is amended by insert-
24 ing after chapter 44 end the following new chapter:



1 **“CHAPTER 45—PROVISIONS RELATING TO**
2 **EXPATRIATED ENTITIES**

“Sec. 4985. Stock compensation of insiders in expatriated corporations.

3 **“SEC. 4985. STOCK COMPENSATION OF INSIDERS IN EXPA-**
4 **TRIATED CORPORATIONS.**

5 “(a) IMPOSITION OF TAX.—In the case of an indi-
6 vidual who is a disqualified individual with respect to any
7 expatriated corporation, there is hereby imposed on such
8 person a tax equal to 15 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 expatriation 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 a stock appreciation right, the
20 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 expatriation date, on such
3 date,

4 “(B) in the case of such compensation
5 which is canceled during the 6 months before
6 the expatriation date, on the day before such
7 cancellation, and

8 “(C) in the case of such compensation
9 which is granted after the expatriation date, on
10 the 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 expatriated corporation
14 only if gain (if any) on any stock in such corporation is
15 recognized in whole or part by any shareholder by reason
16 of the acquisition referred to in section 7874(a)(2)(B)(i)
17 with respect to such corporation.

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

20 “(1) any stock option which is exercised on the
21 expatriation date or during the 6-month period be-
22 fore such date and to the stock acquired in such ex-
23 ercise, if income is recognized under section 83 on
24 or before the expatriation date with respect to the
25 stock acquired pursuant to such exercise, and



1 “(2) any other specified stock compensation
2 which is exercised, sold, exchanged, distributed,
3 cashied-out, or otherwise paid during such period in
4 a transaction in which income, gain, or loss is recog-
5 nized in full.

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

7 “(1) DISQUALIFIED INDIVIDUAL.—The term
8 ‘disqualified individual’ means, with respect to a cor-
9 poration, any individual who, at any time during the
10 12-month period beginning on the date which is 6
11 months before the expatriation date—

12 “(A) is subject to the requirements of sec-
13 tion 16(a) of the Securities Exchange Act of
14 1934 with respect to such corporation or any
15 member of the expanded affiliated group which
16 includes such corporation, or

17 “(B) would be subject to such require-
18 ments if such corporation or member were an
19 issuer of equity securities referred to in such
20 section.

21 “(2) EXPATRIATED CORPORATION; EXPATRIA-
22 TION DATE.—

23 “(A) EXPATRIATED CORPORATION.—The
24 term ‘expatriated corporation’ means any cor-
25 poration which is an expatriated entity (as de-



1 fined in section 7874(a)(2)). Such term in-
2 cludes any predecessor or successor of such a
3 corporation.

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

8 “(3) SPECIFIED STOCK COMPENSATION.—

9 “(A) IN GENERAL.—The term ‘specified
10 stock compensation’ means payment (or right
11 to payment) granted by the expatriated cor-
12 poration (or by any member of the expanded af-
13 filiated group which includes such corporation)
14 to any person in connection with the perform-
15 ance of services by a disqualified individual for
16 such corporation or member if the value of such
17 payment or right is based on (or determined by
18 reference to) the value (or change in value) of
19 stock in such corporation (or any such mem-
20 ber).

21 “(B) EXCEPTIONS.—Such term shall not
22 include—

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



1 “(ii) any payment or right to payment
2 from a plan referred to in section
3 280G(b)(6).

4 “(4) EXPANDED AFFILIATED GROUP.—The
5 term ‘expanded affiliated group’ means an affiliated
6 group (as defined in section 1504(a) without regard
7 to section 1504(b)(3)); except that section 1504(a)
8 shall be applied by substituting ‘more than 50 per-
9 cent’ for ‘at least 80 percent’ each place it appears.
10 “(f) SPECIAL RULES.—For purposes of this
11 section—

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

15 “(2) PAYMENT OR REIMBURSEMENT OF TAX BY
16 CORPORATION TREATED AS SPECIFIED STOCK COM-
17 PENSATION.—Any payment of the tax imposed by
18 this section directly or indirectly by the expatriated
19 corporation or by any member of the expanded affili-
20 ated group which includes such corporation—

21 “(A) shall be treated as specified stock
22 compensation, and

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



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

6 “(4) PROPERTY TRANSFERS.—Any transfer of
7 property shall be treated as a payment and any right
8 to a transfer of property shall be treated as a right
9 to a payment.

10 “(5) OTHER ADMINISTRATIVE PROVISIONS.—
11 For purposes of subtitle F, any tax imposed by this
12 section shall be treated as a tax imposed by subtitle
13 A.

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

17 (b) DENIAL OF DEDUCTION.—

18 (1) IN GENERAL.—Paragraph (6) of section
19 275(a) is amended by inserting “45,” before “46,”.

20 (2) \$1,000,000 LIMIT ON DEDUCTIBLE COM-
21 PENSATION REDUCED BY PAYMENT OF EXCISE TAX
22 ON SPECIFIED STOCK COMPENSATION.—Paragraph
23 (4) of section 162(m) is amended by adding at the
24 end the following new subparagraph:



1 “(G) COORDINATION WITH EXCISE TAX ON
2 SPECIFIED STOCK COMPENSATION.—The dollar
3 limitation contained in paragraph (1) with re-
4 spect to any covered employee shall be reduced
5 (but not below zero) by the amount of any pay-
6 ment (with respect to such employee) of the tax
7 imposed by section 4985 directly or indirectly
8 by the expatriated corporation (as defined in
9 such section) or by any member of the ex-
10 panded affiliated group (as defined in such sec-
11 tion) which includes such corporation.”

12 (c) CONFORMING AMENDMENTS.—

13 (1) The last sentence of section 3121(v)(2)(A)
14 is amended by inserting before the period “or to any
15 specified stock compensation (as defined in section
16 4985) on which tax is imposed by section 4985”.

17 (2) The table of chapters for subtitle D is
18 amended by inserting after the item relating to
19 chapter 44 the following new item:

 “Chapter 45. Provisions relating to expatriated entities.”

20 (d) EFFECTIVE DATE.—The amendments made by
21 this section shall take effect on March 4, 2003; except that
22 periods before such date shall not be taken into account
23 in applying the periods in subsections (a) and (e)(1) of
24 section 4985 of the Internal Revenue Code of 1986, as
25 added by this section.



1 **SEC. 2004. REINSURANCE OF UNITED STATES RISKS IN**
2 **FOREIGN JURISDICTIONS.**

3 (a) **IN GENERAL.**—Section 845(a) (relating to alloca-
4 tion in case of reinsurance agreement involving tax avoid-
5 ance or evasion) is amended by striking “source and char-
6 acter” and inserting “amount, source, or character”.

7 (b) **EFFECTIVE DATE.**—The amendments made by
8 this section shall apply to any risk reinsured after the date
9 of the enactment of this Act.

10 **SEC. 2005. REVISION OF TAX RULES ON EXPATRIATION OF**
11 **INDIVIDUALS.**

12 (a) **EXPATRIATION TO AVOID TAX.**—

13 (1) **IN GENERAL.**—Subsection (a) of section
14 877 (relating to treatment of expatriates) is amend-
15 ed to read as follows:

16 “(a) **TREATMENT OF EXPATRIATES.**—

17 “(1) **IN GENERAL.**—Every nonresident alien in-
18 dividual to whom this section applies and who, with-
19 in the 10-year period immediately preceding the
20 close of the taxable year, lost United States citizen-
21 ship shall be taxable for such taxable year in the
22 manner provided in subsection (b) if the tax imposed
23 pursuant to such subsection (after any reduction in
24 such tax under the last sentence of such subsection)
25 exceeds the tax which, without regard to this section,
26 is imposed pursuant to section 871.



1 “(2) INDIVIDUALS SUBJECT TO THIS SEC-
2 TION.—This section shall apply to any individual
3 if—

4 “(A) the average annual net income tax
5 (as defined in section 38(c)(1)) of such indi-
6 vidual for the period of 5 taxable years ending
7 before the date of the loss of United States citi-
8 zenship is greater than \$122,000,

9 “(B) the net worth of the individual as of
10 such date is \$2,000,000 or more, or

11 “(C) such individual fails to certify under
12 penalty of perjury that he has met the require-
13 ments of this title for the 5 preceding taxable
14 years or fails to submit such evidence of such
15 compliance as the Secretary may require.

16 In the case of the loss of United States citizenship
17 in any calendar year after 2003, such \$122,000
18 amount shall be increased by an amount equal to
19 such dollar amount multiplied by the cost-of-living
20 adjustment determined under section 1(f)(3) for
21 such calendar year by substituting ‘2002’ for ‘1992’
22 in subparagraph (B) thereof. Any increase under the
23 preceding sentence shall be rounded to the nearest
24 multiple of \$1,000.”.



1 (2) REVISION OF EXCEPTIONS FROM ALTER-
2 NATIVE TAX.—Subsection (c) of section 877 (relat-
3 ing to tax avoidance not presumed in certain cases)
4 is amended to read as follows:

5 “(c) EXCEPTIONS.—

6 “(1) IN GENERAL.—Subparagraphs (A) and
7 (B) of subsection (a)(2) shall not apply to an indi-
8 vidual described in paragraph (2) or (3).

9 “(2) DUAL CITIZENS.—

10 “(A) IN GENERAL.—An individual is de-
11 scribed in this paragraph if—

12 “(i) the individual became at birth a
13 citizen of the United States and a citizen
14 of another country and continues to be a
15 citizen of such other country, and

16 “(ii) the individual has had no sub-
17 stantial contacts with the United States.

18 “(B) SUBSTANTIAL CONTACTS.—An indi-
19 vidual shall be treated as having no substantial
20 contacts with the United States only if the
21 individual—

22 “(i) was never a resident of the
23 United States (as defined in section
24 7701(b)),



1 “(ii) has never held a United States
2 passport, and

3 “(iii) was not present in the United
4 States for more than 30 days during any
5 calendar year which is 1 of the 10 calendar
6 years preceding the individual’s loss of
7 United States citizenship.

8 “(3) CERTAIN MINORS.—An individual is de-
9 scribed in this paragraph if—

10 “(A) the individual became at birth a cit-
11 izen of the United States,

12 “(B) neither parent of such individual was
13 a citizen of the United States at the time of
14 such birth,

15 “(C) the individual’s loss of United States
16 citizenship occurs before such individual attains
17 age 18½, and

18 “(D) the individual was not present in the
19 United States for more than 30 days during
20 any calendar year which is 1 of the 10 calendar
21 years preceding the individual’s loss of United
22 States citizenship.”.

23 (3) CONFORMING AMENDMENT.—Section
24 2107(a) is amended to read as follows:



1 “(a) TREATMENT OF EXPATRIATES.—A tax com-
2 puted in accordance with the table contained in section
3 2001 is hereby imposed on the transfer of the taxable es-
4 tate, determined as provided in section 2106, of every de-
5 cedent nonresident not a citizen of the United States if
6 the date of death occurs during a taxable year with respect
7 to which the decedent is subject to tax under section
8 877(b).”.

9 (b) SPECIAL RULES FOR DETERMINING WHEN AN
10 INDIVIDUAL IS NO LONGER A UNITED STATES CITIZEN
11 OR LONG-TERM RESIDENT.—Section 7701 (relating to
12 definitions) is amended by redesignating subsection (n) as
13 subsection (o) and by inserting after subsection (m) the
14 following new subsection:

15 “(n) SPECIAL RULES FOR DETERMINING WHEN AN
16 INDIVIDUAL IS NO LONGER A UNITED STATES CITIZEN
17 OR LONG-TERM RESIDENT.—An individual who would
18 (but for this subsection) cease to be treated as a citizen
19 or resident of the United States shall continue to be treat-
20 ed as a citizen or resident of the United States, as the
21 case may be, until such individual—

22 “(1) gives notice of an expatriating act or ter-
23 mination of residency (with the requisite intent to
24 relinquish citizenship or terminate residency) to the



1 Secretary of State or the Secretary of Homeland Se-
2 curity, and

3 “(2) provides a statement in accordance with
4 section 6039G.”.

5 (c) PHYSICAL PRESENCE IN THE UNITED STATES
6 FOR MORE THAN 30 DAYS.—Section 877 (relating to ex-
7 patriation to avoid tax) is amended by adding at the end
8 the following new subsection:

9 “(g) PHYSICAL PRESENCE.—

10 “(1) IN GENERAL.—This section shall not apply
11 to any individual to whom this section would other-
12 wise apply for any taxable year during the 10-year
13 period referred to in subsection (a) in which such in-
14 dividual is physically present in the United States at
15 any time on more than 30 days in the calendar year
16 ending in such taxable year, and such individual
17 shall be treated for purposes of this title as a citizen
18 or resident of the United States, as the case may be,
19 for such taxable year.

20 “(2) EXCEPTION.—

21 “(A) IN GENERAL.—In the case of an indi-
22 vidual described in any of the following sub-
23 paragraphs of this paragraph, a day of physical
24 presence in the United States shall be dis-
25 regarded if the individual is performing services



1 in the United States on such day for an em-
2 ployer. The preceding sentence shall not apply
3 if—

4 “(i) such employer is related (within
5 the meaning of section 267 and 707) to
6 such individual, or

7 “(ii) such employer fails to meet such
8 requirements as the Secretary may pre-
9 scribe by regulations to prevent the avoid-
10 ance of the purposes of this paragraph.

11 Not more than 30 days during any calendar
12 year may be disregarded under this subpara-
13 graph.

14 “(B) INDIVIDUALS WITH TIES TO OTHER
15 COUNTRIES.—An individual is described in this
16 subparagraph if—

17 “(i) the individual becomes (not later
18 than the close of a reasonable period after
19 loss of United States citizenship or termi-
20 nation of residency) a citizen or resident of
21 the country in which—

22 “(I) such individual was born,

23 “(II) if such individual is mar-
24 ried, such individual’s spouse was
25 born, or



1 “(III) either of such individual’s
2 parents were born, and

3 “(ii) the individual becomes fully lia-
4 ble for income tax in such country.

5 “(C) MINIMAL PRIOR PHYSICAL PRESENCE
6 IN THE UNITED STATES.—An individual is de-
7 scribed in this subparagraph if, for each year in
8 the 10-year period ending on the date of loss of
9 United States citizenship or termination of resi-
10 dency, the individual was physically present in
11 the United States for 30 days or less. The rule
12 of section 7701(b)(3)(D)(ii) shall apply for pur-
13 poses of this subparagraph.”.

14 (d) TRANSFERS SUBJECT TO GIFT TAX.—

15 (1) IN GENERAL.—Subsection (a) of section
16 2501 (relating to taxable transfers) is amended by
17 striking paragraph (4), by redesignating paragraph
18 (5) as paragraph (4), and by striking paragraph (3)
19 and inserting the following new paragraph:

20 “(3) EXCEPTION.—

21 “(A) CERTAIN INDIVIDUALS.—Paragraph
22 (2) shall not apply in the case of a donor to
23 whom section 877(b) applies for the taxable
24 year which includes the date of the transfer.



1 “(B) CREDIT FOR FOREIGN GIFT TAXES.—
2 The tax imposed by this section solely by reason
3 of this paragraph shall be credited with the
4 amount of any gift tax actually paid to any for-
5 eign country in respect of any gift which is tax-
6 able under this section solely by reason of this
7 paragraph.”

8 (2) TRANSFERS OF CERTAIN STOCK.—Sub-
9 section (a) of section 2501 is amended by adding at
10 the end the following new paragraph:

11 “(5) TRANSFERS OF CERTAIN STOCK.—

12 “(A) IN GENERAL.—In the case of a trans-
13 fer of stock in a foreign corporation described
14 in subparagraph (B) by a donor to whom sec-
15 tion 877(b) applies for the taxable year which
16 includes the date of the transfer—

17 “(i) section 2511(a) shall be applied
18 without regard to whether such stock is
19 situated within the United States, and

20 “(ii) the value of such stock for pur-
21 poses of this chapter shall be its U.S.-asset
22 value determined under subparagraph (C).

23 “(B) FOREIGN CORPORATION DE-
24 SCRIBED.—A foreign corporation is described in
25 this subparagraph with respect to a donor if—



1 “(i) the donor owned (within the
2 meaning of section 958(a)) at the time of
3 such transfer 10 percent or more of the
4 total combined voting power of all classes
5 of stock entitled to vote of the foreign cor-
6 poration, and

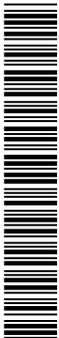
7 “(ii) such donor owned (within the
8 meaning of section 958(a)), or is consid-
9 ered to have owned (by applying the own-
10 ership rules of section 958(b)), at the time
11 of such transfer, more than 50 percent
12 of—

13 “(I) the total combined voting
14 power of all classes of stock entitled
15 to vote of such corporation, or

16 “(II) the total value of the stock
17 of such corporation.

18 “(C) U.S.-ASSET VALUE.—For purposes of
19 subparagraph (A), the U.S.-asset value of stock
20 shall be the amount which bears the same ratio
21 to the fair market value of such stock at the
22 time of transfer as—

23 “(i) the fair market value (at such
24 time) of the assets owned by such foreign



1 corporation and situated in the United
2 States, bears to

3 “(ii) the total fair market value (at
4 such time) of all assets owned by such for-
5 eign corporation.”

6 (e) ENHANCED INFORMATION REPORTING FROM IN-
7 DIVIDUALS LOSING UNITED STATES CITIZENSHIP.—

8 (1) IN GENERAL.—Subsection (a) of section
9 6039G is amended to read as follows:

10 “(a) IN GENERAL.—Notwithstanding any other pro-
11 vision of law, any individual to whom section 877(b) ap-
12 plies for any taxable year shall provide a statement for
13 such taxable year which includes the information described
14 in subsection (b).”.

15 (2) INFORMATION TO BE PROVIDED.—Sub-
16 section (b) of section 6039G is amended to read as
17 follows:

18 “(b) INFORMATION TO BE PROVIDED.—Information
19 required under subsection (a) shall include—

20 “(1) the taxpayer’s TIN,

21 “(2) the mailing address of such individual’s
22 principal foreign residence,

23 “(3) the foreign country in which such indi-
24 vidual is residing,



1 “(4) the foreign country of which such indi-
2 vidual is a citizen,

3 “(5) information detailing the income, assets,
4 and liabilities of such individual,

5 “(6) the number of days during any portion of
6 which that the individual was physically present in
7 the United States during the taxable year, and

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

10 (3) INCREASE IN PENALTY.—Subsection (d) of
11 section 6039G is amended to read as follows:

12 “(d) PENALTY.—If—

13 “(1) an individual is required to file a state-
14 ment under subsection (a) for any taxable year, and

15 “(2) fails to file such a statement with the Sec-
16 retary on or before the date such statement is re-
17 quired to be filed or fails to include all the informa-
18 tion required to be shown on the statement or in-
19 cludes incorrect information,

20 such individual shall pay a penalty of \$10,000 unless it
21 is shown that such failure is due to reasonable cause and
22 not to willful neglect.”.

23 (4) CONFORMING AMENDMENT.—Section
24 6039G is amended by striking subsections (e), (f),



1 and (g) and by redesignating subsections (d) and (e)
2 as subsection (c) and (d), respectively.

3 (f) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to individuals who expatriate after
5 February 27, 2003.

6 **SEC. 2006. REPORTING OF TAXABLE MERGERS AND ACQUI-**
7 **SITIONS.**

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

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

12 “(a) IN GENERAL.—According to the forms or regu-
13 lations prescribed by the Secretary, the acquiring corpora-
14 tion in any taxable acquisition shall make a return setting
15 forth—

16 “(1) a description of the acquisition,

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

20 “(3) the amount of money and the fair market
21 value of other property transferred to each such
22 shareholder as part of such acquisition, and

23 “(4) such other information as the Secretary
24 may prescribe.



1 To the extent provided by the Secretary, the requirements
2 of this section applicable to the acquiring corporation shall
3 be applicable to the acquired corporation and not to the
4 acquiring corporation.

5 “(b) NOMINEES.—According to the forms or regula-
6 tions prescribed by the Secretary—

7 “(1) REPORTING.—Any person who holds stock
8 as a nominee for another person shall furnish in the
9 manner prescribed by the Secretary to such other
10 person the information provided by the corporation
11 under subsection (d).

12 “(2) REPORTING TO NOMINEES.—In the case of
13 stock held by any person as a nominee, references in
14 this section (other than in subsection (c)) to a share-
15 holder shall be treated as a reference to the nomi-
16 nee.

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

23 “(d) STATEMENTS TO BE FURNISHED TO SHARE-
24 HOLDERS.—According to the forms or regulations pre-
25 scribed by the Secretary, every person required to make



1 a return under subsection (a) shall furnish to each share-
2 holder whose name is required to be set forth in such re-
3 turn a written statement showing—

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

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

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

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

15 (b) ASSESSABLE PENALTIES.—

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

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

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



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

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

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

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

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

14 **SEC. 2007. STUDIES.**

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



1 Code of 1986, a review of the regulatory and administra-
2 tive guidance implementing the principles of section 482
3 of such Code to transactions involving intangible property
4 and services and to cost-sharing arrangements, and an ex-
5 amination of whether increased disclosure of cross-border
6 transactions should be required. The study shall set forth
7 specific recommendations to address all abuses identified
8 in the study. Not later than June 30, 2004, such Sec-
9 retary or delegate shall submit to the Congress a report
10 of such study.

11 (b) INCOME TAX TREATIES.—The Secretary of the
12 Treasury or the Secretary's delegate shall conduct a study
13 of United States income tax treaties to identify any inap-
14 propriate reductions in United States withholding tax that
15 provide opportunities for shifting income out of the United
16 States, and to evaluate whether existing anti-abuse mecha-
17 nisms are operating properly. The study shall include spe-
18 cific recommendations to address all inappropriate uses of
19 tax treaties. Not later than June 30, 2004, such Secretary
20 or delegate shall submit to the Congress a report of such
21 study.

22 (c) IMPACT OF CORPORATE EXPATRIATION PROVI-
23 SIONS.—The Secretary of the Treasury or the Secretary's
24 delegate shall conduct a study of the impact of the provi-
25 sions of this title on earnings stripping and corporate ex-



1 patriation. The study shall include such recommendations
2 as such Secretary or delegate may have to improve the
3 impact of such provisions in carrying out the purposes of
4 this title. Not later than December 31, 2005, such Sec-
5 retary or delegate shall submit to the Congress a report
6 of such study.

7 **TITLE III—PROVISIONS**
8 **RELATING TO TAX SHELTERS**
9 **Subtitle A—Taxpayer-Related**
10 **Provisions**

11 **SEC. 3001. PENALTY FOR FAILING TO DISCLOSE REPORT-**
12 **ABLE TRANSACTIONS.**

13 (a) IN GENERAL.—Part I of subchapter B of chapter
14 68 (relating to assessable penalties) is amended by insert-
15 ing after section 6707 the following new section:

16 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**
17 **ABLE TRANSACTION INFORMATION WITH RE-**
18 **TURN.**

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

25 “(b) AMOUNT OF PENALTY.—



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

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

6 “(B) \$50,000 in any other case.

7 “(2) LISTED TRANSACTION.—The amount of
8 the penalty under subsection (a) with respect to a
9 listed transaction shall be—

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

12 “(B) \$200,000 in any other case.

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

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

22 “(2) LISTED TRANSACTION.—The term ‘listed
23 transaction’ means a reportable transaction which is
24 the same as, or substantially similar to, a trans-
25 action specifically identified by the Secretary as a



1 tax avoidance transaction for purposes of section
2 6011.

3 “(d) AUTHORITY TO RESCIND PENALTY.—

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

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

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

14 “(2) NO JUDICIAL APPEAL.—Notwithstanding
15 any other provision of law, any determination under
16 this subsection may not be reviewed in any judicial
17 proceeding.

18 “(3) RECORDS.—If a penalty is rescinded under
19 paragraph (1), the Commissioner shall place in the
20 file in the Office of the Commissioner the opinion of
21 the Commissioner or the head of the Office of Tax
22 Shelter Analysis with respect to the determination,
23 including—

24 “(A) a statement of the facts and cir-
25 cumstances relating to the violation,



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

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

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

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

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

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

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

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

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



1 **SEC. 3002. ACCURACY-RELATED PENALTY FOR LISTED**
 2 **TRANSACTIONS, OTHER REPORTABLE TRANS-**
 3 **ACTIONS HAVING A SIGNIFICANT TAX AVOID-**
 4 **ANCE PURPOSE, ETC.**

5 (a) IN GENERAL.—Subchapter A of chapter 68 is
 6 amended by inserting after section 6662 the following new
 7 section:

8 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
 9 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
 10 **TO REPORTABLE TRANSACTIONS.**

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

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

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

19 “(A) the product of—

20 “(i) the amount of the increase (if
 21 any) in taxable income which results from
 22 a difference between the proper tax treat-
 23 ment of an item to which this section ap-
 24 plies and the taxpayer’s treatment of such
 25 item (as shown on the taxpayer’s return of
 26 tax), and



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

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

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

17 “(2) ITEMS TO WHICH SECTION APPLIES.—This
18 section shall apply to any item which is attributable
19 to—

20 “(A) any listed transaction, and

21 “(B) any reportable transaction (other
22 than a listed transaction) if a significant pur-
23 pose of such transaction is the avoidance or
24 evasion of Federal income tax.



1 “(c) HIGHER PENALTY FOR NONDISCLOSED TRANS-
2 ACTIONS.—Subsection (a) shall be applied by substituting
3 ‘30 percent’ for ‘20 percent’ with respect to the portion
4 of any reportable transaction understatement with respect
5 to which the requirement of section 6664(d)(2)(A) is not
6 met.

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(c).

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 for pur-
20 poses of determining whether such understate-
21 ment is a substantial understatement under
22 section 6662(d)(1), and

23 “(B) the addition to tax under section
24 6662(a) shall apply only to the excess of the
25 amount of the substantial understatement (if



1 any) after the application of subparagraph (A)
2 over the aggregate amount of reportable trans-
3 action understatements.

4 “(2) COORDINATION WITH OTHER PEN-
5 ALTIES.—

6 “(A) APPLICATION OF FRAUD PENALTY.—
7 References to an underpayment in section 6663
8 shall be treated as including references to a re-
9 reportable transaction understatement.

10 “(B) NO DOUBLE PENALTY.—This section
11 shall not apply to any portion of an understatement
12 on which a penalty is imposed under section
13 6663.”

14 “(3) SPECIAL RULE FOR AMENDED RE-
15 TURNS.—Except as provided in regulations, in no
16 event shall any tax treatment included with an
17 amendment or supplement to a return of tax be
18 taken into account in determining the amount of any
19 reportable transaction understatement if the amend-
20 ment or supplement is filed after the earlier of the
21 date the taxpayer is first contacted by the Secretary
22 regarding the examination of the return or such
23 other date as is specified by the Secretary.”

24 (b) DETERMINATION OF OTHER UNDERSTATE-
25 MENTS.—Subparagraph (A) of section 6662(d)(2) is



1 amended by adding at the end the following flush sen-
2 tence:

3 “The excess under the preceding sentence shall
4 be determined without regard to items to which
5 section 6662A applies.”

6 (c) REASONABLE CAUSE EXCEPTION.—

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

9 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
10 ABLE TRANSACTION UNDERSTATEMENTS.—

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

17 “(2) SPECIAL RULES.—Paragraph (1) shall not
18 apply to any reportable transaction understatement
19 unless—

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

24 “(B) there is or was substantial authority
25 for such treatment, and



1 “(C) the taxpayer reasonably believed that
2 such treatment was more likely than not the
3 proper treatment.

4 A taxpayer failing to adequately disclose in accord-
5 ance with section 6011 shall be treated as meeting
6 the requirements of subparagraph (A) if the penalty
7 for such failure was rescinded under section
8 6707A(d).

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

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

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

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



1 “(B) CERTAIN OPINIONS MAY NOT BE RE-
2 LIED UPON.—

3 “(i) IN GENERAL.—An opinion of a
4 tax advisor may not be relied upon to es-
5 tablish the reasonable belief of a taxpayer
6 if—

7 “(I) the tax advisor is described
8 in clause (ii), or

9 “(II) the opinion is described in
10 clause (iii).

11 “(ii) DISQUALIFIED TAX ADVISORS.—
12 A tax advisor is described in this clause if
13 the tax advisor—

14 “(I) is a material advisor (within
15 the meaning of section 6111(b)(1))
16 and participates in the organization,
17 management, promotion, or sale of
18 the transaction or is related (within
19 the meaning of section 267(b) or
20 707(b)(1)) to any person who so par-
21 ticipates,

22 “(II) is compensated directly or
23 indirectly by a material advisor with
24 respect to the transaction,



1 “(III) has a fee arrangement
2 with respect to the transaction which
3 is contingent on all or part of the in-
4 tended tax benefits from the trans-
5 action being sustained, or

6 “(IV) as determined under regu-
7 lations prescribed by the Secretary,
8 has a disqualifying financial interest
9 with respect to the transaction.

10 “(iii) DISQUALIFIED OPINIONS.—For
11 purposes of clause (i), an opinion is dis-
12 qualified if the opinion—

13 “(I) is based on unreasonable
14 factual or legal assumptions (includ-
15 ing assumptions as to future events),

16 “(II) unreasonably relies on rep-
17 resentations, statements, findings, or
18 agreements of the taxpayer or any
19 other person,

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

22 “(IV) fails to meet any other re-
23 quirement as the Secretary may pre-
24 scribe.”

25 (2) CONFORMING AMENDMENTS.—



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

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

7 (d) REDUCTION IN PENALTY FOR SUBSTANTIAL UN-
8 DERSTATEMENT OF INCOME TAX NOT TO APPLY TO TAX
9 SHELTERS.—Subparagraph (C) of section 6662(d)(2) (re-
10 lating to substantial understatement of income tax) is
11 amended to read as follows:

12 “(C) REDUCTION NOT TO APPLY TO TAX
13 SHELTERS.—

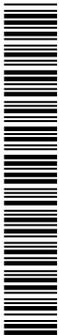
14 “(i) IN GENERAL.—Subparagraph (B)
15 shall not apply to any item attributable to
16 a tax shelter.

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

19 “(I) a partnership or other enti-
20 ty,

21 “(II) any investment plan or ar-
22 rangement, or

23 “(III) any other plan or arrange-
24 ment,



1 if a significant purpose of such partner-
2 ship, entity, plan, or arrangement is the
3 avoidance or evasion of Federal income
4 tax.”

5 (e) CONFORMING AMENDMENTS.—

6 (1) Sections 461(i)(3)(C), 1274(b)(3), and
7 7525(b) are each amended by striking “section
8 6662(d)(2)(C)(iii)” and inserting “section
9 6662(d)(2)(C)(ii)”.

10 (2) The heading for section 6662 is amended to
11 read as follows:

12 **“SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY**
13 **ON UNDERPAYMENTS.”**

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

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

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

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



1 **SEC. 3003. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
2 **PRIVILEGES RELATING TO TAXPAYER COM-**
3 **MUNICATIONS.**

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

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

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

13 “(A) any person,

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

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

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

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



1 **SEC. 3004. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
2 **FOR WHICH REQUIRED LISTED TRANS-**
3 **ACTIONS NOT REPORTED.**

4 (a) IN GENERAL.—Section 6501(c) (relating to ex-
5 ceptions) is amended by adding at the end the following
6 new paragraph:

7 “(10) LISTED TRANSACTIONS.—If a taxpayer
8 fails to include on any return or statement for any
9 taxable year any information with respect to a listed
10 transaction (as defined in section 6707A(c)(2))
11 which is required under section 6011 to be included
12 with such return or statement, the time for assess-
13 ment of any tax imposed by this title with respect
14 to such transaction shall not expire before the date
15 which is 1 year after the earlier of—

16 “(A) the date on which the Secretary is
17 furnished the information so required, or

18 “(B) the date that a material advisor (as
19 defined in section 6111) meets the requirements
20 of section 6112 with respect to a request by the
21 Secretary under section 6112(b) relating to
22 such transaction with respect to such tax-
23 payer.”

24 (b) EFFECTIVE DATE.—The amendment made by
25 this section shall apply to taxable years with respect to



1 which the period for assessing a deficiency did not expire
2 before the date of the enactment of this Act.

3 **SEC. 3005. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

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

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

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

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

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

20 “(1) MATERIAL ADVISOR.—

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

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



1 plementing, or carrying out any reportable
2 transaction, and

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

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

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

14 “(ii) \$250,000 in any other case.

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

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

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

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



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

3 (b) CONFORMING AMENDMENTS.—

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

 “Sec. 6111. Disclosure of reportable transactions.”

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

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

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

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

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

23 (3) Section 6112 is amended—

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



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

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

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

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

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

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

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

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

18 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
19 **OF CONFIDENTIALITY.**—Paragraph (1) of section
20 6112(b), as redesignated by subsection (b), is amended by
21 adding at the end the following new flush sentence:

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



1 (d) EFFECTIVE DATE.—

2 (1) IN GENERAL.—Except as provided in para-
3 graph (2), the amendments made by this section
4 shall apply to transactions with respect to which ma-
5 terial aid, assistance, or advice referred to in section
6 6111(b)(1)(A)(i) of the Internal Revenue Code of
7 1986 (as added by this section) is provided after the
8 date of the enactment of this Act.

9 (2) NO CLAIM OF CONFIDENTIALITY AGAINST
10 DISCLOSURE.—The amendment made by subsection
11 (c) shall take effect as if included in the amend-
12 ments made by section 142 of the Deficit Reduction
13 Act of 1984.

14 **SEC. 3006. FAILURE TO FURNISH INFORMATION REGARD-**
15 **ING REPORTABLE TRANSACTIONS.**

16 (a) IN GENERAL.—Section 6707 (relating to failure
17 to furnish information regarding tax shelters) is amended
18 to read as follows:

19 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
20 **ING REPORTABLE TRANSACTIONS.**

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

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



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

5 “(b) AMOUNT OF PENALTY.—

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

9 “(2) LISTED TRANSACTIONS.—The penalty im-
10 posed under subsection (a) with respect to any listed
11 transaction shall be an amount equal to the greater
12 of—

13 “(A) \$200,000, or

14 “(B) 50 percent of the gross income de-
15 rived by such person with respect to aid, assist-
16 ance, or advice which is provided with respect
17 to the listed transaction before the date the re-
18 turn is filed under section 6111.

19 Subparagraph (B) shall be applied by substituting
20 ‘75 percent’ for ‘50 percent’ in the case of an inten-
21 tional failure or act described in subsection (a).

22 “(c) RESCISSION AUTHORITY.—The provisions of
23 section 6707A(d) (relating to authority of Commissioner
24 to rescind penalty) shall apply to any penalty imposed
25 under this section.



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

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

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

12 **SEC. 3007. MODIFICATION OF PENALTY FOR FAILURE TO**
13 **MAINTAIN LISTS OF INVESTORS.**

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

16 “(a) IMPOSITION OF PENALTY.—

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

24 “(2) REASONABLE CAUSE EXCEPTION.—No
25 penalty shall be imposed by paragraph (1) with re-



1 spect to the failure on any day if such failure is due
2 to reasonable cause.”.

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

6 **SEC. 3008. PENALTY ON PROMOTERS OF TAX SHELTERS.**

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

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

19 **SEC. 3009. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
20 **MENT PENALTY FOR NONREPORTABLE**
21 **TRANSACTIONS.**

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



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

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

11 “(ii) \$10,000,000.”

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

15 **SEC. 3010. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
16 **CONDUCT RELATED TO TAX SHELTERS AND**
17 **REPORTABLE TRANSACTIONS.**

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

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



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

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

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

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

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

18 “(c) SPECIFIED CONDUCT.—For purposes of this
19 section, the term ‘specified conduct’ means any action, or
20 failure to take action, subject to penalty under section
21 6700, 6701, 6707, or 6708.”

22 (b) CONFORMING AMENDMENTS.—

23 (1) The heading for section 7408 is amended to
24 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. 3011. PENALTY ON FAILURE TO REPORT INTERESTS**
12 **IN FOREIGN FINANCIAL ACCOUNTS.**

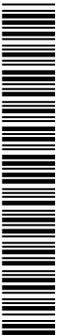
13 (a) **IN GENERAL.**—Section 5321(a)(5) of title 31,
14 United States Code, is amended to read as follows:

15 “(5) **FOREIGN FINANCIAL AGENCY TRANS-**
16 **ACTION VIOLATION.**—

17 “(A) **PENALTY AUTHORIZED.**—The Sec-
18 retary of the Treasury may impose a civil
19 money penalty on any person who violates, or
20 causes any violation of, any provision of section
21 5314.

22 “(B) **AMOUNT OF PENALTY.**—

23 “(i) **IN GENERAL.**—Except as pro-
24 vided in subparagraph (C), the amount of



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. 3012. REGULATION OF INDIVIDUALS PRACTICING BE-**
16 **FORE THE DEPARTMENT OF THE TREASURY.**

17 (a) CENSURE; IMPOSITION OF PENALTY.—

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

20 (A) by inserting “, or censure,” after “De-
21 partment”, and

22 (B) by adding at the end the following new
23 flush sentence:

24 “The Secretary may impose a monetary penalty on any
25 representative described in the preceding sentence. If the



1 representative was acting on behalf of an employer or any
2 firm or other entity in connection with the conduct giving
3 rise to such penalty, the Secretary may impose a monetary
4 penalty on such employer, firm, or entity if it knew, or
5 reasonably should have known, of such conduct. Such pen-
6 alty shall not exceed the gross income derived (or to be
7 derived) from the conduct giving rise to the penalty. Any
8 such penalty imposed on an individual may be in addition
9 to, or in lieu of, any suspension, disbarment, or censure
10 of such individual.”

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

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

17 “(d) Nothing in this section or in any other provision
18 of law shall be construed to limit the authority of the Sec-
19 retary of the Treasury to impose standards applicable to
20 the rendering of written advice with respect to any entity,
21 transaction plan or arrangement, or other plan or arrange-
22 ment, which is of a type which the Secretary determines
23 as having a potential for tax avoidance or evasion.”



1 **Subtitle B—Other Provisions**

2 **SEC. 3021. TREATMENT OF STRIPPED INTERESTS IN BOND**

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

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

8 “(f) TREATMENT OF STRIPPED INTERESTS IN BOND
9 AND PREFERRED STOCK FUNDS, ETC.—In the case of an
10 account or entity substantially all of the assets of which
11 consist of bonds, preferred stock, or a combination thereof,
12 the Secretary may by regulations provide that rules simi-
13 lar to the rules of this section and 305(e), as appropriate,
14 shall apply to interests in such account or entity to which
15 (but for this subsection) this section or section 305(e), as
16 the case may be, would not apply.”

17 (b) CROSS REFERENCE.—Subsection (e) of section
18 305 is amended by adding at the end the following new
19 paragraph:

20 “(7) CROSS REFERENCE.—

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

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



1 **SEC. 3022. MINIMUM HOLDING PERIOD FOR FOREIGN TAX**
2 **CREDIT ON WITHHOLDING TAXES ON INCOME**
3 **OTHER THAN DIVIDENDS.**

4 (a) IN GENERAL.—Section 901 is amended by redess-
5 ignating subsection (l) as subsection (m) and by inserting
6 after subsection (k) the following new subsection:

7 “(l) MINIMUM HOLDING PERIOD FOR WITHHOLDING
8 TAXES ON GAIN AND INCOME OTHER THAN DIVIDENDS
9 ETC.—

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

14 “(A) such property is held by the recipient
15 of the item for 15 days or less during the 30-
16 day period beginning on the date which is 15
17 days before the date on which the right to re-
18 ceive payment of such item arises, or

19 “(B) to the extent that the recipient of the
20 item is under an obligation (whether pursuant
21 to a short sale or otherwise) to make related
22 payments with respect to positions in substan-
23 tially similar or related property.

24 This paragraph shall not apply to any dividend to
25 which subsection (k) applies.



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

3 “(A) IN GENERAL.—Paragraph (1) shall
4 not apply to any qualified tax with respect to
5 any property held in the active conduct in a for-
6 eign country of a business as a dealer in such
7 property.

8 “(B) QUALIFIED TAX.—For purposes of
9 subparagraph (A), the term ‘qualified tax’
10 means a tax paid to a foreign country (other
11 than the foreign country referred to in subpara-
12 graph (A)) if—

13 “(i) the item to which such tax is at-
14 tributable is subject to taxation on a net
15 basis by the country referred to in sub-
16 paragraph (A), and

17 “(ii) such country allows a credit
18 against its net basis tax for the full
19 amount of the tax paid to such other for-
20 eign country.

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

23 “(i) with respect to a security, any
24 person to whom paragraphs (1) and (2) of
25 subsection (k) would not apply by reason



1 of paragraph (4) thereof if such security
2 were stock, and

3 “(ii) with respect to any other prop-
4 erty, any person with respect to whom
5 such property is described in section
6 1221(a)(1).

7 “(D) REGULATIONS.—The Secretary may
8 prescribe such regulations as may be appro-
9 priate to carry out this paragraph, including
10 regulations to prevent the abuse of the excep-
11 tion provided by this paragraph and to treat
12 other taxes as qualified taxes.

13 “(3) EXCEPTIONS.—The Secretary may by reg-
14 ulation provide that paragraph (1) shall not apply to
15 property where the Secretary determines that the
16 application of paragraph (1) to such property is not
17 necessary to carry out the purposes of this sub-
18 section.

19 “(4) CERTAIN RULES TO APPLY.—Rules similar
20 to the rules of paragraphs (5), (6), and (7) of sub-
21 section (k) shall apply for purposes of this sub-
22 section.

23 “(5) DETERMINATION OF HOLDING PERIOD.—
24 Holding periods shall be determined for purposes of



1 this subsection without regard to section 1235 or
2 any similar rule.”

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

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

9 **SEC. 3023. DISALLOWANCE OF CERTAIN PARTNERSHIP**
10 **LOSS TRANSFERS.**

11 (a) TREATMENT OF CONTRIBUTED PROPERTY WITH
12 BUILT-IN LOSS.—Paragraph (1) of section 704(c) is
13 amended by striking “and” at the end of subparagraph
14 (A), by striking the period at the end of subparagraph
15 (B) and inserting “, and”, and by adding at the end the
16 following:

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

19 “(i) such built-in loss shall be taken
20 into account only in determining the
21 amount of items allocated to the contrib-
22 uting partner, and

23 “(ii) except as provided in regulations,
24 in determining the amount of items allo-
25 cated to other partners, the basis of the



1 contributed property in the hands of the
2 partnership shall be treated as being equal
3 to its fair market value at the time of con-
4 tribution.

5 For purposes of subparagraph (C), the term ‘built-
6 in loss’ means the excess of the adjusted basis of the
7 property (determined without regard to subpara-
8 graph (C)(ii)) over its fair market value at the time
9 of contribution.”

10 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-
11 erty ON TRANSFER OF PARTNERSHIP INTEREST IF
12 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

13 (1) ADJUSTMENT REQUIRED.—Subsection (a)
14 of section 743 (relating to optional adjustment to
15 basis of partnership property) is amended by insert-
16 ing before the period “or unless the partnership has
17 a substantial built-in loss immediately after such
18 transfer”.

19 (2) ADJUSTMENT.—Subsection (b) of section
20 743 is amended by inserting “or with respect to
21 which there is a substantial built-in loss immediately
22 after such transfer” after “section 754 is in effect”.

23 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743
24 is amended by adding at the end the following new
25 subsection:



1 “(d) SUBSTANTIAL BUILT-IN LOSS.—

2 “(1) IN GENERAL.—For purposes of this sec-
3 tion, a partnership has a substantial built-in loss
4 with respect to a transfer of an interest in a part-
5 nership if the partnership’s adjusted basis in the
6 partnership property exceeds by more than \$250,000
7 the fair market value of such property.

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

15 (4) CLERICAL AMENDMENTS.—

16 (A) The section heading for section 743 is
17 amended to read as follows:

18 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**
19 **ERTY WHERE SECTION 754 ELECTION OR**
20 **SUBSTANTIAL BUILT-IN LOSS.”**

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

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



1 (c) ADJUSTMENT TO BASIS OF UNDISTRIBUTED
2 PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL
3 BASIS REDUCTION.—

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

9 (2) ADJUSTMENT.—Subsection (b) of section
10 734 is amended by inserting “or unless there is a
11 substantial basis reduction” after “section 754 is in
12 effect”.

13 (3) SUBSTANTIAL BASIS REDUCTION.—Section
14 734 is amended by adding at the end the following
15 new subsection:

16 “(d) SUBSTANTIAL BASIS REDUCTION.—

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

22 “(2) REGULATIONS.—

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

23 (4) CLERICAL AMENDMENTS.—



1 (A) The section heading for section 734 is
2 amended to read as follows:

3 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
4 **PARTNERSHIP PROPERTY WHERE SECTION**
5 **754 ELECTION OR SUBSTANTIAL BASIS RE-**
6 **DUCTION.”**

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

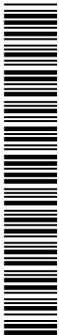
“Sec. 734. Adjustment to basis of undistributed partnership prop-
erty where section 754 election or substantial basis
reduction.”

11 (d) EFFECTIVE DATES.—

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

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

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



1 **SEC. 3024. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
2 **STOCK HELD BY PARTNERSHIP IN COR-**
3 **PORATE PARTNER.**

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

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

10 “(1) no allocation may be made to stock in a
11 corporation (or any person related (within the mean-
12 ing of sections 267(b) and 707(b)(1)) to such cor-
13 poration) which is a partner in the partnership, and

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

17 Gain shall be recognized to the partnership to the extent
18 that the amount required to be allocated under paragraph
19 (2) to other partnership property exceeds the aggregate
20 adjusted basis of such other property immediately before
21 the allocation required by paragraph (2).”

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



1 **SEC. 3025. REPEAL OF SPECIAL RULES FOR FASITS.**

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

5 (b) CONFORMING AMENDMENTS.—

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

9 (2) Clause (ii) of section 382(l)(4)(B) is amend-
10 ed by striking “a REMIC to which part IV of sub-
11 chapter M applies, or a FASIT to which part V of
12 subchapter M applies,” and inserting “or a REMIC
13 to which part IV of subchapter M applies,”.

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

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

19 (5)(A) Section 860G(a)(1) is amended by add-
20 ing at the end the following new sentence: “An inter-
21 est shall not fail to qualify as a regular interest sole-
22 ly because the specified principal amount of the reg-
23 ular interest (or the amount of interest accrued on
24 the regular interest) can be reduced as a result of
25 the nonoccurrence of 1 or more contingent payments
26 with respect to any reverse mortgage loan held by



1 the REMIC if, on the startup day for the REMIC,
2 the sponsor reasonably believes that all principal and
3 interest due under the regular interest will be paid
4 at or prior to the liquidation of the REMIC.”.

5 (B) The last sentence of section 860G(a)(3) is
6 amended by inserting “, and any reverse mortgage
7 loan (and each balance increase on such loan meet-
8 ing the requirements of subparagraph (A)(iii)) shall
9 be treated as an obligation secured by an interest in
10 real property” before the period at the end.

11 (6) Paragraph (3) of section 860G(a) is amend-
12 ed by adding “and” at the end of subparagraph (B),
13 by striking “, and” at the end of subparagraph (C)
14 and inserting a period, and by striking subparagraph
15 (D).

16 (7) Section 860G(a)(3), as amended by para-
17 graph (6), is amended by adding at the end the fol-
18 lowing new sentence: “For purposes of subparagraph
19 (A), if more than 50 percent of the obligations
20 transferred to, or purchased by, the REMIC are
21 originated by the United States or any State (or any
22 political subdivision, agency, or instrumentality of
23 the United States or any State) and are principally
24 secured by an interest in real property, then each
25 obligation transferred to, or purchased by, the



1 REMIC shall be treated as secured by an interest in
2 real property.”.

3 (8)(A) Section 860G(a)(3)(A) is amended by
4 striking “or” at the end of clause (i), by inserting
5 “or” at the end of clause (ii), and by inserting after
6 clause (ii) the following new clause:

7 “(iii) represents an increase in the
8 principal amount under the original terms
9 of an obligation described in clause (i) or
10 (ii) if—

11 “(I) such increase in the balance
12 is attributable to an advance made to
13 the obligor pursuant to the original
14 terms of the obligation,

15 “(II) such increase in the balance
16 occurs after the startup day, and

17 “(III) such increase in the bal-
18 ance is purchased by the REMIC pur-
19 suant to a fixed price contract in ef-
20 fect on the startup day.”.

21 (B) Section 860G(a)(7)(B) is amended to read
22 as follows:

23 “(B) QUALIFIED RESERVE FUND.—For
24 purposes of subparagraph (A), the term ‘quali-



1 fied reserve fund’ means any reasonably re-
2 quired reserve to—

3 “(i) provide for full payment of ex-
4 penses of the REMIC or amounts due on
5 regular interests in the event of defaults on
6 qualified mortgages or lower than expected
7 returns on cash flow investments, or

8 “(ii) provide a source of funds for the
9 purchase of obligations described in clause
10 (ii) or (iii) of paragraph (3)(A).

11 The aggregate fair market value of the assets
12 held in any such reserve shall not exceed 50
13 percent of the aggregate fair market value of all
14 of the assets of the REMIC on the startup day,
15 and the amount of any such reserve shall be
16 promptly and appropriately reduced to the ex-
17 tent the amount held in such reserve is no
18 longer reasonably required for purposes speci-
19 fied in clause (i) or (ii) of paragraph (3)(A).”.

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

23 (10) Section 1272(a)(6)(B) is amended by add-
24 ing at the end the following new flush sentence:



1 “For purposes of clause (iii), the Secretary
2 shall prescribe regulations permitting the use of
3 a current prepayment assumption, determined
4 as of the close of the accrual period (or such
5 other time as the Secretary may prescribe dur-
6 ing the taxable year in which the accrual period
7 ends).”.

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

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

15 (c) EFFECTIVE DATE.—

16 (1) IN GENERAL.—Except as provided in para-
17 graph (2), the amendments made by this section
18 shall apply to taxable years beginning after Decem-
19 ber 31, 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. 3026. LIMITATION ON TRANSFER OF BUILT-IN LOSSES**
11 **ON REMIC RESIDUALS.**

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

15 “(e) LIMITATION ON TRANSFER OF BUILT-IN
16 LOSSES ON REMIC RESIDUALS IN SECTION 351 TRANS-
17 ACTIONS.—If—

18 “(1) a residual interest (as defined in section
19 860G(a)(2)) in a REMIC is transferred in any
20 transaction which is described in subsection (a), and

21 “(2) the transferee’s adjusted basis in such re-
22 sidual interest would (but for this paragraph) exceed
23 its fair market value immediately after such trans-
24 action,



1 then, notwithstanding subsection (a), the transferee's ad-
2 justed basis in such residual interest shall not exceed its
3 fair market value (whether or not greater than zero) im-
4 mediately after such transaction.”

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

8 **SEC. 3027. CLARIFICATION OF BANKING BUSINESS FOR**
9 **PURPOSES OF DETERMINING INVESTMENT**
10 **OF EARNINGS IN UNITED STATES PROPERTY.**

11 (a) IN GENERAL.—Subparagraph (A) of section
12 956(c)(2) is amended to read as follows:

13 “(A) obligations of the United States,
14 money, or deposits with any corporation with
15 respect to which a bank holding company (with-
16 in the meaning of section 2(a) of the Bank
17 Holding Company Act of 1956 (12 U.S.C.
18 1841(a))) or financial holding company (within
19 the meaning of section 2(p) of such Act) owns
20 directly or indirectly more than 80 percent by
21 vote or value of the stock of such corporation;”.

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



1 **SEC. 3028. MODIFICATIONS RELATED TO CERTAIN SMALL**
2 **INSURANCE COMPANIES.**

3 (a) EXEMPTION FOR SMALL PROPERTY AND CAS-
4 UALTY INSURANCE COMPANIES.—

5 (1) IN GENERAL.—Section 501(c)(15)(A) is
6 amended to read as follows:

7 “(A) Insurance companies (as defined in
8 section 816(a)) other than life (including inter-
9 insurers and reciprocal underwriters) if—

10 “(i) the gross receipts for the taxable
11 year do not exceed \$600,000, and

12 “(ii) more than 50 percent of such
13 gross receipts consist of premiums.”.

14 (2) CONTROLLED GROUP RULE.—Section
15 501(c)(15)(C) is amended by inserting “, except that
16 in applying section 1563 for purposes of section
17 831(b)(2)(B)(ii), subparagraphs (B) and (C) of sec-
18 tion 1563(b)(2) shall be disregarded” before the pe-
19 riod at the end.

20 (3) CONFORMING AMENDMENT.—Clause (i) of
21 section 831(b)(2)(A) is amended by striking “exceed
22 \$350,000 but”.

23 (b) ALTERNATIVE TAX FOR CERTAIN SMALL INSUR-
24 ANCE COMPANIES.—



1 (1) INCREASED LIMITATION.—Clause (i) of sec-
2 tion 831(b)(2)(A) is amended by striking
3 “\$1,200,000” and inserting “\$1,890,000”.

4 (2) INFLATION ADJUSTMENT.—Paragraph (2)
5 of section 831(b) is amended by adding at the end
6 the following new subparagraph:

7 “(C) INFLATION ADJUSTMENT.—In the
8 case of any taxable year beginning in a calendar
9 year after 2004, the \$1,890,000 amount in sub-
10 paragraph (A) shall be increased by an amount
11 equal to—

12 “(i) \$1,890,000, multiplied by

13 “(ii) the cost-of-living adjustment de-
14 termined under section 1(f)(3) for such
15 calendar year by substituting ‘calendar
16 year 2003’ for ‘calendar year 1992’ in sub-
17 paragraph (B) thereof.

18 If the amount as adjusted under the preceding
19 sentence is not a multiple of \$1,000, such
20 amount shall be rounded to the next lowest
21 multiple of \$1,000.”.

22 (c) EFFECTIVE DATE.—The amendments made by
23 this section shall apply to taxable years beginning after
24 December 31, 2003.



1 **SEC. 3029. DEFINITION OF INSURANCE COMPANY FOR SEC-**
2 **TION 831.**

3 (a) IN GENERAL.—Section 831 is amended by redес-
4 ignating subsection (c) as subsection (d) and by inserting
5 after subsection (b) the following new subsection:

6 “(c) INSURANCE COMPANY DEFINED.—For purposes
7 of this section, the term ‘insurance company’ has the
8 meaning given to such term by section 816(a).”

9 (b) EFFECTIVE DATE.—The amendment made by
10 this section shall apply to taxable years beginning after
11 December 31, 2003.

12 **SEC. 3030. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
13 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
14 **CLOSED REPORTABLE TRANSACTIONS.**

15 (a) IN GENERAL.—Section 163 (relating to deduction
16 for interest) is amended by redesignating subsection (m)
17 as subsection (n) and by inserting after subsection (l) the
18 following new subsection:

19 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE
20 TO NONDISCLOSED REPORTABLE TRANSACTIONS.—No
21 deduction shall be allowed under this chapter for any in-
22 terest paid or accrued under section 6601 on any under-
23 payment of tax which is attributable to the portion of any
24 reportable transaction understatement (as defined in sec-
25 tion 6662A(b)) with respect to which the requirement of
26 section 6664(d)(2)(A) is not met.”



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

4 **SEC. 3031. CLARIFICATION OF RULES FOR PAYMENT OF ES-**
5 **TIMATED TAX FOR CERTAIN DEEMED ASSET**
6 **SALES.**

7 (a) IN GENERAL.—Paragraph (13) of section 338(h)
8 (relating to tax on deemed sale not taken into account for
9 estimated tax purposes) is amended by adding at the end
10 the following: “The preceding sentence shall not apply
11 with respect to a qualified stock purchase for which an
12 election is made under paragraph (10).”.

13 (b) EFFECTIVE DATE.—The amendment made by
14 subsection (a) shall apply to transactions occurring after
15 the date of the enactment of this Act.

16 **SEC. 3032. RECOGNITION OF GAIN FROM THE SALE OF A**
17 **PRINCIPAL RESIDENCE ACQUIRED IN A LIKE-**
18 **KIND EXCHANGE WITHIN 5 YEARS OF SALE.**

19 (a) IN GENERAL.—Section 121(d) (relating to special
20 rules for exclusion of gain from sale of principal residence)
21 is amended by adding at the end the following new para-
22 graph:

23 “(10) PROPERTY ACQUIRED IN LIKE-KIND EX-
24 CHANGE.—If a taxpayer acquired property in an ex-
25 change to which section 1031 applied, subsection (a)



1 shall not apply to the sale or exchange of such prop-
2 erty if it occurs during the 5-year period beginning
3 with the date of the acquisition of such property.”.

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

7 **SEC. 3033. PREVENTION OF MISMATCHING OF INTEREST**
8 **AND ORIGINAL ISSUE DISCOUNT DEDUC-**
9 **TIONS AND INCOME INCLUSIONS IN TRANS-**
10 **ACTIONS WITH RELATED FOREIGN PERSONS.**

11 (a) ORIGINAL ISSUE DISCOUNT.—Section 163(e)(3)
12 (relating to special rule for original issue discount on obli-
13 gation held by related foreign person) is amended by re-
14 designating subparagraph (B) as subparagraph (C) and
15 by inserting after subparagraph (A) the following new sub-
16 paragraph:

17 “(B) SPECIAL RULE FOR CERTAIN FOR-
18 EIGN ENTITIES.—

19 “(i) IN GENERAL.—In the case of any
20 debt instrument having original issue dis-
21 count which is held by a related foreign
22 person which is a foreign personal holding
23 company (as defined in section 552), a
24 controlled foreign corporation (as defined
25 in section 957), or a passive foreign invest-



1 ment company (as defined in section
2 1297), a deduction shall be allowable to
3 the issuer with respect to such original
4 issue discount for any taxable year only
5 when paid or to the extent such original
6 issue discount is included during such tax-
7 able year in the gross income of a United
8 States person who owns (within the mean-
9 ing of section 958(a)) stock in such cor-
10 poration.

11 “(ii) SECRETARIAL AUTHORITY.—The
12 Secretary may by regulation exempt trans-
13 actions from the application of clause (i),
14 including any transaction which is entered
15 into by a payor in the ordinary course of
16 a trade or business in which the payor is
17 predominantly engaged.”.

18 (b) INTEREST AND OTHER DEDUCTIBLE
19 AMOUNTS.—Section 267(a)(3) is amended—

20 (1) by striking “The Secretary” and inserting:

21 “(A) IN GENERAL.—The Secretary”, and

22 (2) by adding at the end the following new sub-
23 paragraph:

24 “(B) SPECIAL RULE FOR CERTAIN FOR-
25 EIGN ENTITIES.—



1 “(i) IN GENERAL.—Notwithstanding
2 subparagraph (A), in the case of any
3 amount payable to a foreign personal hold-
4 ing company (as defined in section 552), a
5 controlled foreign corporation (as defined
6 in section 957), or a passive foreign invest-
7 ment company (as defined in section
8 1297), a deduction shall be allowable to
9 the payor with respect to such amount for
10 any taxable year only when paid or to the
11 extent such amount is included during
12 such taxable year in the gross income of a
13 United States person who owns (within the
14 meaning of section 958(a)) stock in such
15 corporation.

16 “(ii) SECRETARIAL AUTHORITY.—The
17 Secretary may by regulation exempt trans-
18 actions from the application of clause (i),
19 including any transaction which is entered
20 into by a payor in the ordinary course of
21 a trade or business in which the payor is
22 predominantly engaged and in which the
23 payment of the accrued amounts occurs
24 within 8½ months after accrual or within



1 such other period as the Secretary may
2 prescribe.”.

3 (c) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to payments accrued on or after
5 the date of the enactment of this Act.

6 **SEC. 3034. EXCLUSION FROM GROSS INCOME FOR INTER-**
7 **EST ON OVERPAYMENTS OF INCOME TAX BY**
8 **INDIVIDUALS.**

9 (a) IN GENERAL.—Part III of subchapter B of chap-
10 ter 1 (relating to items specifically excluded from gross
11 income) is amended by inserting after section 139A the
12 following new section:

13 **“SEC. 139B. EXCLUSION FROM GROSS INCOME FOR INTER-**
14 **EST ON OVERPAYMENTS OF INCOME TAX BY**
15 **INDIVIDUALS.**

16 “(a) IN GENERAL.—In the case of an individual,
17 gross income shall not include interest paid under section
18 6611 on any overpayment of tax imposed by this subtitle.

19 “(b) EXCEPTION.—Subsection (a) shall not apply in
20 the case of a failure to claim items resulting in the over-
21 payment on the original return if the Secretary determines
22 that the principal purpose of such failure is to take advan-
23 tage of subsection (a).

24 “(c) SPECIAL RULE FOR DETERMINING MODIFIED
25 ADJUSTED GROSS INCOME.—For purposes of this title,



1 interest not included in gross income under subsection (a)
2 shall not be treated as interest which is exempt from tax
3 for purposes of sections 32(i)(2)(B) and 6012(d) or any
4 computation in which interest exempt from tax under this
5 title is added to adjusted gross income.”.

6 (b) CLERICAL AMENDMENT.—The table of sections
7 for part III of subchapter B of chapter 1 is amended by
8 inserting after the item relating to section 139A the fol-
9 lowing new item:

“Sec. 139B. Exclusion from gross income for interest on over-
payments of income tax by individuals.”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to interest received in calendar
12 years beginning after the date of the enactment of this
13 Act.

14 **SEC. 3035. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
15 **TEREST ON POTENTIAL UNDERPAYMENTS.**

16 (a) IN GENERAL.—Subchapter A of chapter 67 (re-
17 lating to interest on underpayments) is amended by add-
18 ing at the end the following new section:

19 **“SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
20 **TEREST ON POTENTIAL UNDERPAYMENTS,**
21 **ETC.**

22 “(a) AUTHORITY TO MAKE DEPOSITS OTHER THAN
23 AS PAYMENT OF TAX.—A taxpayer may make a cash de-
24 posit with the Secretary which may be used by the Sec-



1 retary to pay any tax imposed under subtitle A or B or
2 chapter 41, 42, 43, or 44 which has not been assessed
3 at the time of the deposit. Such a deposit shall be made
4 in such manner as the Secretary shall prescribe.

5 “(b) NO INTEREST IMPOSED.—To the extent that
6 such deposit is used by the Secretary to pay tax, for pur-
7 poses of section 6601 (relating to interest on underpay-
8 ments), the tax shall be treated as paid when the deposit
9 is made.

10 “(c) RETURN OF DEPOSIT.—Except in a case where
11 the Secretary determines that collection of tax is in jeop-
12 ardy, the Secretary shall return to the taxpayer any
13 amount of the deposit (to the extent not used for a pay-
14 ment of tax) which the taxpayer requests in writing.

15 “(d) PAYMENT OF INTEREST.—

16 “(1) IN GENERAL.—For purposes of section
17 6611 (relating to interest on overpayments), a de-
18 posit which is returned to a taxpayer shall be treated
19 as a payment of tax for any period to the extent
20 (and only to the extent) attributable to a disputable
21 tax for such period. Under regulations prescribed by
22 the Secretary, rules similar to the rules of section
23 6611(b)(2) shall apply.

24 “(2) DISPUTABLE TAX.—



1 “(A) IN GENERAL.—For purposes of this
2 section, the term ‘disputable tax’ means the
3 amount of tax specified at the time of the de-
4 posit as the taxpayer’s reasonable estimate of
5 the maximum amount of any tax attributable to
6 disputable items.

7 “(B) SAFE HARBOR BASED ON 30-DAY
8 LETTER.—In the case of a taxpayer who has
9 been issued a 30-day letter, the maximum
10 amount of tax under subparagraph (A) shall
11 not be less than the amount of the proposed de-
12 ficiency specified in such letter.

13 “(3) OTHER DEFINITIONS.—For purposes of
14 paragraph (2)—

15 “(A) DISPUTABLE ITEM.—The term ‘dis-
16 putable item’ means any item of income, gain,
17 loss, deduction, or credit if the taxpayer—

18 “(i) has a reasonable basis for its
19 treatment of such item, and

20 “(ii) reasonably believes that the Sec-
21 retary also has a reasonable basis for dis-
22 allowing the taxpayer’s treatment of such
23 item.

24 “(B) 30-DAY LETTER.—The term ‘30-day
25 letter’ means the first letter of proposed defi-



1 ciency which allows the taxpayer an opportunity
2 for administrative review in the Internal Rev-
3 enue Service Office of Appeals.

4 “(4) RATE OF INTEREST.—The rate of interest
5 allowable under this subsection shall be the Federal
6 short-term rate determined under section 6621(b),
7 compounded daily.

8 “(e) USE OF DEPOSITS.—

9 “(1) PAYMENT OF TAX.—Except as otherwise
10 provided by the taxpayer, deposits shall be treated
11 as used for the payment of tax in the order depos-
12 ited.

13 “(2) RETURNS OF DEPOSITS.—Deposits shall
14 be treated as returned to the taxpayer on a last-in,
15 first-out basis.”.

16 (b) CLERICAL AMENDMENT.—The table of sections
17 for subchapter A of chapter 67 is amended by adding at
18 the end the following new item:

 “Sec. 6603. Deposits made to suspend running of interest on po-
 tential underpayments, etc.”.

19 (c) EFFECTIVE DATE.—

20 (1) IN GENERAL.—The amendments made by
21 this section shall apply to deposits made after the
22 date of the enactment of this Act.

23 (2) COORDINATION WITH DEPOSITS MADE
24 UNDER REVENUE PROCEDURE 84–58.—In the case of



1 an amount held by the Secretary of the Treasury or
2 his delegate on the date of the enactment of this Act
3 as a deposit in the nature of a cash bond deposit
4 pursuant to Revenue Procedure 84-58, the date that
5 the taxpayer identifies such amount as a deposit
6 made pursuant to section 6603 of the Internal Rev-
7 enue Code (as added by this Act) shall be treated as
8 the date such amount is deposited for purposes of
9 such section 6603.

10 **SEC. 3036. PARTIAL PAYMENT OF TAX LIABILITY IN IN-**
11 **STALLMENT AGREEMENTS.**

12 (a) IN GENERAL.—

13 (1) Section 6159(a) (relating to authorization
14 of agreements) is amended—

15 (A) by striking “satisfy liability for pay-
16 ment of” and inserting “make payment on”,
17 and

18 (B) by inserting “full or partial” after “fa-
19 cilitate”.

20 (2) Section 6159(e) (relating to Secretary re-
21 quired to enter into installment agreements in cer-
22 tain cases) is amended in the matter preceding para-
23 graph (1) by inserting “full” before “payment”.

24 (b) REQUIREMENT TO REVIEW PARTIAL PAYMENT
25 AGREEMENTS EVERY TWO YEARS.—Section 6159, as



1 amended by this Act, is amended by redesignating sub-
2 sections (d), (e), and (f) as subsections (e), (f), and (g),
3 respectively, and inserting after subsection (c) the fol-
4 lowing new subsection:

5 “(d) SECRETARY REQUIRED TO REVIEW INSTALL-
6 MENT AGREEMENTS FOR PARTIAL COLLECTION EVERY
7 TWO YEARS.—In the case of an agreement entered into
8 by the Secretary under subsection (a) for partial collection
9 of a tax liability, the Secretary shall review the agreement
10 at least once every 2 years.”.

11 (c) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to agreements entered into on or
13 after the date of the enactment of this Act.

14 **SEC. 3037. EXTENSION OF IRS USER FEES.**

15 (a) IN GENERAL.—Section 7528(c) (relating to ter-
16 mination) is amended by striking “December 31, 2004”
17 and inserting “September 30, 2013”.

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



1 **TITLE IV—TRADE ENHANCE-**
 2 **MENT AND COMPLIANCE PRO-**
 3 **VISIONS**

4 **SEC. 4001. REPEAL OF EXCLUSION FOR**
 5 **EXTRATERRITORIAL INCOME.**

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

7 (b) CONFORMING AMENDMENTS.—

8 (1) Subpart E of part III of subchapter N of
 9 chapter 1 (relating to qualifying foreign trade in-
 10 come) is hereby repealed.

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

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

16 (c) EFFECTIVE DATE.—Except as provided in sub-
 17 section (d), the amendments made by this section shall
 18 apply to transactions after December 31, 2003.

19 (d) TRANSITIONAL RULE FOR 2004, 2005, AND 2006.—

20 (1) IN GENERAL.—In the case of transactions
 21 during 2004, 2005, or 2006, the amount includible
 22 in gross income by reason of the amendments made
 23 by this section shall not exceed the applicable per-
 24 centage of the amount which would have been so in-
 25 cluded but for this subsection.



1 (2) APPLICABLE PERCENTAGE.—For purposes
2 of paragraph (1), the applicable percentage shall be
3 as follows:

4 (A) For 2004, the applicable percentage
5 shall be 20 percent.

6 (B) For 2005, the applicable percentage
7 shall be 20 percent.

8 (C) For 2006, the applicable percentage
9 shall be 40 percent.

10 (e) REVOCATION OF ELECTION TO BE TREATED AS
11 DOMESTIC CORPORATION.—If, during the 1-year period
12 beginning on the date of the enactment of this Act, a cor-
13 poration for which an election is in effect under section
14 943(e) of the Internal Revenue Code of 1986 revokes such
15 election, no gain or loss shall be recognized with respect
16 to property treated as transferred under clause (ii) of sec-
17 tion 943(e)(4)(B) of such Code to the extent such
18 property—

19 (1) was treated as transferred under clause (i)
20 thereof, or

21 (2) was acquired during a taxable year to which
22 such election applies and before May 1, 2003, in the
23 ordinary course of its trade or business.



1 The Secretary of the Treasury (or such Secretary's dele-
2 gate) may prescribe such regulations as may be necessary
3 to prevent the abuse of the purposes of this subsection.

4 (f) **BINDING CONTRACTS.**—The amendments made
5 by this section shall not apply to any transaction in the
6 ordinary course of a trade or business which occurs pursu-
7 ant to a binding contract—

8 (1) which is between the taxpayer and a person
9 who is not a related person (as defined in section
10 943(b)(3) of such Code, as in effect on the day be-
11 fore the date of the enactment of this Act), and

12 (2) which is in effect on January 14, 2002, and at
13 all times thereafter.

14 For purposes of this subsection, a binding contract shall
15 include a purchase option, renewal option, or replacement
16 option which is included in such contract and which is en-
17 forceable against the seller or lessor.

18 **SEC. 4002. COBRA FEES.**

19 (a) **USE OF MERCHANDISE PROCESSING FEE.**—Sec-
20 tion 13031(f) of the Consolidated Omnibus Budget Rec-
21 onciliation Act of 1985 (19 U.S.C. 58c(f)) is amended—

22 (1) in paragraph (1), by aligning subparagraph
23 (B) with subparagraph (A); and

24 (2) in paragraph (2), by striking “commercial
25 operations” and all that follows through “proc-



1 essing.” and inserting “customs revenue functions as
2 defined in section 415 of the Homeland Security Act
3 of 2002 (other than functions performed by the Of-
4 fice of International Affairs referred to in section
5 415(8) of that Act), and for automation (including
6 the Automation Commercial Environment computer
7 system), and for no other purpose. To the extent
8 that funds in the Customs User Fee Account are in-
9 sufficient to pay the costs of such customs revenue
10 functions, customs duties in an amount equal to the
11 amount of such insufficiency shall be available, to
12 the extent provided for in appropriations Acts, to
13 pay the costs of such customs revenue functions in
14 the amount of such insufficiency, and shall be avail-
15 able for no other purpose. The provisions of the first
16 and second sentences of this paragraph specifying
17 the purposes for which amounts in the Customs
18 User Fee Account may be made available shall not
19 be superseded except by a provision of law which
20 specifically modifies or supersedes such provisions.”.

21 (b) REIMBURSEMENT OF APPROPRIATIONS FROM
22 COBRA FEES.—Section 13031(f)(3) of the Consolidated
23 Omnibus Budget Reconciliation Act of 1985 (19 U.S.C.
24 58c(f)(3)) is amended by adding at the end the following:



1 “(E) Nothing in this paragraph shall be construed
2 to preclude the use of appropriated funds, from sources
3 other than the fees collected under subsection (a), to pay
4 the costs set forth in clauses (i), (ii), and (iii) of subpara-
5 graph (A).”.

6 (c) SENSE OF CONGRESS; EFFECTIVE PERIOD FOR
7 COLLECTING FEES; STANDARD FOR SETTING FEES.—

8 (1) SENSE OF CONGRESS.—The Congress finds
9 that—

10 (A) the fees set forth in paragraphs (1)
11 through (8) of subsection (a) of section 13031
12 of the Consolidated Omnibus Budget Reconcili-
13 ation Act of 1985 have been reasonably related
14 to the costs of providing customs services in
15 connection with the activities or items for which
16 the fees have been charged under such para-
17 graphs; and

18 (B) the fees collected under such para-
19 graphs have not exceeded, in the aggregate, the
20 amounts paid for the costs described in sub-
21 section (f)(3)(A) incurred in providing customs
22 services in connection with the activities or
23 items for which the fees were charged under
24 such paragraphs.



1 (2) EFFECTIVE PERIOD; STANDARD FOR SET-
2 TING FEES.—Section 13031(j)(3) of the Consoli-
3 dated Omnibus Budget Reconciliation Act of 1985 is
4 amended to read as follows:

5 “(3)(A) Fees may not be charged under paragraphs
6 (9) and (10) of subsection (a) after September 30, 2013.

7 “(B)(i) Subject to clause (ii), Fees may not be
8 charged under paragraphs (1) through (8) of subsection
9 (a) after September 30, 2013.

10 “(ii) In fiscal year 2006 and in each succeeding fiscal
11 year for which fees under paragraphs (1) through (8) of
12 subsection (a) are authorized—

13 “(I) the Secretary of the Treasury shall charge
14 fees under each such paragraph in amounts that are
15 reasonably related to the costs of providing customs
16 services in connection with the activity or item for
17 which the fee is charged under such paragraph, ex-
18 cept that in no case may the fee charged under any
19 such paragraph exceed by more than 10 percent the
20 amount otherwise prescribed by such paragraph;

21 “(II) the amount of fees collected under such
22 paragraphs may not exceed, in the aggregate, the
23 amounts paid in that fiscal year for the costs de-
24 scribed in subsection (f)(3)(A) incurred in providing
25 customs services in connection with the activity or



1 item for which the fees are charged under such
2 paragraphs;

3 “(III) a fee may not be collected under any
4 such paragraph except to the extent such fee will be
5 expended to pay the costs described in subsection
6 (f)(3)(A) incurred in providing customs services in
7 connection with the activity or item for which the fee
8 is charged under such paragraph;

9 “(IV) any fee collected under any such para-
10 graph shall be available for expenditure only to pay
11 the costs described in subsection (f)(3)(A) incurred
12 in providing customs services in connection with the
13 activity or item for which the fee is charged under
14 such paragraph.”.

15 (d) CLERICAL AMENDMENTS.—Section 13031 of the
16 Consolidated Omnibus Budget Reconciliation Act of 1985
17 is amended—

18 (1) in subsection (a)(5)(B), by striking “\$1.75”
19 and inserting “\$1.75.”;

20 (2) in subsection (b)—

21 (A) in paragraph (1)(A), by aligning clause
22 (iii) with clause (ii);

23 (B) in paragraph (7), by striking “para-
24 graphs” and inserting “paragraph”; and



1 (C) in paragraph (9), by aligning subpara-
2 graph (B) with subparagraph (A); and

3 (3) in subsection (e)(2), by aligning subpara-
4 graph (B) with subparagraph (A).

5 (e) STUDY OF ALL FEES COLLECTED BY DEPART-
6 MENT OF HOMELAND SECURITY.—The Secretary of the
7 Treasury shall conduct a study of all the fees collected
8 by the Department of Homeland Security, and shall sub-
9 mit to the Congress, not later than September 30, 2005,
10 a report containing the recommendations of the Secretary
11 on—

12 (1) what fees should be eliminated;

13 (2) what the rate of fees retained should be;

14 and

15 (3) any other recommendations with respect to
16 the fees that the Secretary considers appropriate.

