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

IN THE HOUSE OF REPRESENTATIVES

JULY 11, 2002

Mr. THOMAS (for himself, Mr. McCRERY, Mrs. JOHNSON of Connecticut, and Mr. HOUGHTON) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

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

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; ETC.

(a) Short Title.—This Act may be cited as the “American Competitiveness and Corporate Accountability Act of 2002”.

(b) Amendment of 1986 Code.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment or repeal of an existing section, such amendment or repeal shall apply to this Act as well as to the section so amended or repealed.
to, or repeal of, a section or other provision, the reference
shall be considered to be made to a section or other provi-

(c) Table of Contents.—

Sec. 1. Short title; etc.

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TITLE I—PROVISIONS RELATING TO TAX SHELTERS

Subtitle A—Taxpayer-Related Provisions

SEC. 101. CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.

(a) In General.—Section 7701 is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

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

“(1) General rules.—

“(A) In general.—In applying the economic substance doctrine, the determination of whether a transaction has economic substance shall be made as provided in this paragraph.

“(B) Definition of economic substance.—For purposes of subparagraph (A), a transaction has economic substance only if—

“(i) the transaction changes in a meaningful way (apart from Federal in-
come tax effects) the taxpayer’s economic
position, and

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

“(2) Economic Substance Doctrine.—For
purposes of this subsection, the term ‘economic sub-
stance doctrine’ means the common law doctrine
under which tax benefits under subtitle A with re-
spect to a transaction are not allowable if the trans-
action does not have economic substance or lacks a
business purpose.

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

(b) Effective Date.—The amendment made by
this section shall apply to transactions after the date of
the enactment of this Act.
SEC. 102. PENALTY FOR FAILING TO DISCLOSE REPORTABLE TRANSACTIONS.

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

“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORTABLE TRANSACTION INFORMATION WITH RETURN.

“(a) IMPOSITION OF PENALTY.—Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under section 6011 to be included with such return or statement shall pay a penalty in the amount determined under subsection (b).

“(b) AMOUNT OF PENALTY.—

“(1) IN GENERAL.—Except as provided in paragraph (2), the amount of the penalty under subsection (a) shall be—

“(A) $10,000 in the case of a natural person, and

“(B) $50,000 in any other case.

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

“(A) $100,000 in the case of a natural person, and
“(B) $200,000 in any other case.

“(e) Definitions.—For purposes of this section—

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

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

“(d) Authority to rescind penalty.—

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

“(A) the violation is with respect to a re-
portable transaction other than a listed trans-
action,
“(B) the person on whom the penalty is imposed has a history of complying with the requirements of this title,

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

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

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

“(2) DISCRETION.—The exercise of authority under paragraph (1) shall be at the sole discretion of the Commissioner and may be delegated only to the head of the Office of Tax Shelter Analysis. The Commissioner, in his sole discretion, may establish a procedure to determine if a penalty should be referred to the Commissioner or the head of such Office for a determination under paragraph (1).

“(3) NO APPEAL.—Notwithstanding any other provision of law, any determination under this subsection may not be reviewed in any administrative or judicial proceeding.

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

“(A) the reasons for the rescission, and

“(B) the amount of the penalty rescinded.

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

(b) CONFORMING AMENDMENT.—The table of sections for part I of subchapter B of chapter 68 is amended by inserting after the item relating to section 6707 the following:

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

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

(d) REPORT.—The Commissioner of Internal Revenue shall annually report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate—

(1) a summary of the total number and aggregate amount of penalties imposed, and rescinded, under section 6707A of the Internal Revenue Code of 1986, and
(2) a description of each penalty rescinded under section 6707(c) of such Code and the reasons therefor.

SEC. 103. ACCURACY-RELATED PENALTY FOR LISTED TRANSACTIONS, OTHER REPORTABLE TRANSACTIONS HAVING A SIGNIFICANT TAX AVOIDANCE PURPOSE, ETC.

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

“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PENALTY ON UNDERSTATEMENTS WITH RESPECT TO REPORTABLE TRANSACTIONS.

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

“(b) REPORTABLE TRANSACTION UNDERSTATEMENT.—For purposes of this section—

“(1) IN GENERAL.—The term ‘reportable transaction understatement’ means the sum of—

“(A) the product of—

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

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

“(B) the amount of the decrease (if any) in the aggregate amount of credits determined under subtitle A which results from a difference between the taxpayer’s treatment of an item to which this section applies (as shown on the taxpayer’s return of tax) and the proper tax treatment of such item.

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

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

“(A) any listed transaction, and
“(B) any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax.

“(c) **Higher Penalty for Nondisclosed Transactions.**—Subsection (a) shall be applied by substituting ‘30 percent’ for ‘20 percent’ with respect to the portion of any reportable transaction understatement with respect to which the requirement of section 6664(d)(2)(A) is not met.

“(d) **Definitions of Reportable and Listed Transactions.**—For purposes of this section, the terms ‘reportable transaction’ and ‘listed transaction’ have the respective meanings given to such terms by section 6707A(c).

“(e) **Special Rules.**—

“(1) **Coordination with Penalties, etc., on Other Understatements.**—In the case of an understatement (as defined in section 6662(d)(2))—

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

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

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

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

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

“(3) SPECIAL RULE FOR AMENDED RE-
TURNS.—Except as provided in regulations, in no
event shall any tax treatment included with an
amendment or supplement to a return of tax be
taken into account in determining the amount of any reportable transaction understatement or noneconomic substance transaction understatement if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by the Secretary regarding the examination of the return or such other date as is specified by the Secretary.

“(4) NONECONOMIC SUBSTANCE TRANSACTION UNDERSTATEMENT.—For purposes of this subsection, the term ‘noneconomic substance transaction understatement’ has the meaning given to such term by section 6662B(c).”

(b) DETERMINATION OF OTHER UNDERSTATEMENTS.—Subparagraph (A) of section 6662(d)(2) is amended by adding at the end the following flush sentence:

“The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies and without regard to items with respect to which a penalty is imposed by section 6662B.”

(c) REASONABLE CAUSE EXCEPTION.—

(1) IN GENERAL.—Section 6664 is amended by adding at the end the following new subsection:
“(d) Reasonable Cause Exception for Reportable Transaction Understatements.—

“(1) In general.—No penalty shall be imposed under section 6662A with respect to any portion of a reportable transaction understatement if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

“(2) Special rules.—Paragraph (1) shall not apply to any reportable transaction understatement unless—

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

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

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

“(3) Rules relating to reasonable belief.—For purposes of paragraph (2)(C)—

“(A) In general.—A taxpayer shall be treated as having a reasonable belief with re-
spect to the tax treatment of an item only if
such belief—

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

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

“(B) Certain opinions may not be re-
lied upon.—

“(i) In general.—An opinion of a
tax advisor may not be relied upon to es-
establish the reasonable belief of a taxpayer
if—

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

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

“(ii) Disqualified tax advisors.—
A tax advisor is described in this clause if
the tax advisor—
“(I) is a material advisor (within the meaning of section 6111(b)(1)) and participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates,

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

“(III) has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained, or

“(IV) as determined under regulations prescribed by the Secretary, has a continuing financial interest with respect to the transaction.

“(iii) DISQUALIFIED OPINIONS.—For purposes of clause (i), an opinion is disqualified if the opinion—
“(I) is based on unreasonable factual or legal assumptions (including assumptions as to future events),
“(II) unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person,
“(III) does not identify and consider all relevant facts, or
“(IV) fails to meet any other requirement as the Secretary may prescribe.”

(2) CONFORMING AMENDMENTS.—

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

(B) The heading for subsection (c) of section 6664 is amended by inserting “FOR UNDERPAYMENTS” after “EXCEPTION”.

(d) REDUCTION IN PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX NOT TO APPLY TO TAX SHELTERS.—Subparagraph (C) of section 6662(d)(2) (relating to substantial understatement of income tax) is amended to read as follows:
“(C) Reduction Not to Apply to Tax Shelters.—

“(i) In General.—Subparagraph (B) shall not apply to any item attributable to a tax shelter.

“(ii) Tax Shelter.—For purposes of clause (i), the term ‘tax shelter’ means—

“(I) a partnership or other entity,

“(II) any investment plan or arrangement, or

“(III) any other plan or arrangement,

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.”

(e) Conforming Amendments.—

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

(2) The heading for section 6662 is amended to read as follows:
“SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY ON UNDERPAYMENTS.”

(3) The table of sections for part II of subchapter A of chapter 68 is amended by striking the item relating to section 6662 and inserting the following new items:

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

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

SEC. 104. PENALTY FOR UNDERSTATEMENTS ATTRIBUTABLE TO TRANSACTIONS LACKING ECONOMIC SUBSTANCE, ETC.

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

“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIBUTABLE TO TRANSACTIONS LACKING ECONOMIC SUBSTANCE, ETC.

“(a) IMPOSITION OF PENALTY.—If a taxpayer has an noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of such understatement.
“(b) Reduction of Penalty for Disclosed Transactions.—Subsection (a) shall be applied by substituting ‘20 percent’ for ‘40 percent’ with respect to the portion of any noneconomic substance transaction understatement with respect to which the relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with the regulations prescribed under section 6011.

“(c) Noneconomic Substance Transaction Understatement.—For purposes of this section—

“(1) In General.—The term ‘noneconomic substance transaction understatement’ means any amount which would be an understatement under section 6662A(b)(1) if such section only applied to items attributable to noneconomic substance transactions.

“(2) Noneconomic Substance Transaction.—The term ‘noneconomic substance transaction’ means any transaction if—

“(A) the transaction lacks economic substance (within the meaning of section 7701(m)), or

“(B) the transaction fails to meet the requirements of any similar rule of law.
“(3) Exception for personal transactions of individuals.—In the case of an individual, such term shall not include any transaction other than a transaction entered into in connection with a trade or business or an activity engaged in for the production of income.

“(d) Coordination with other penalties.—

“(1) In general.—Except as otherwise provided in this part, the penalty imposed by this section shall be in addition to any other penalty imposed by this title.

“(2) Cross reference.—

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

(b) Clerical amendment.—The table of sections for part II of subchapter A of chapter 68 is amended by inserting after the item relating to section 6662A the following new item:

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

(e) Effective date.—The amendments made by this section shall apply to transactions after the date of the enactment of this Act.
SEC. 105. TAX SHELTER EXCEPTION TO CONFIDENTIALITY PRIVILEGES RELATING TO TAXPAYER COMMUNICATIONS.

(a) In General.—Section 7525(b) (relating to section not to apply to communications regarding corporate tax shelters) is amended to read as follows:

“(b) Section Not To Apply To Communications Regarding Tax Shelters.—The privilege under subsection (a) shall not apply to any written communication which is—

“(1) between a federally authorized tax practitioner and—

“(A) any person,

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

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

“(2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).”

(b) Effective Date.—The amendment made by this section shall apply to communications made on or after the date of the enactment of this Act.
SEC. 106. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS TRANSFERS.

(a) Treatment of Contributed Property With Built-In Loss.—Paragraph (1) of section 704(c) is amended by striking “and” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, and”, and by adding at the end the following:

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

“(i) such built-in loss shall be taken into account only in determining the amount of items allocated to the contributing partner, and

“(ii) except as provided in regulations, in determining the amount of items allocated to other partners, the basis of the contributed property in the hands of the partnership shall be treated as being equal to its fair market value immediately after the contribution.

For purposes of subparagraph (C), the term ‘built-in loss’ means the excess of the adjusted basis of the property over its fair market value immediately after the contribution.”
(b) Adjustment to Basis of Partnership Property on Transfer of Partnership Interest If There Is Substantial Built-In Loss.—

(1) Adjustment Required.—Subsection (a) of section 743 (relating to optional adjustment to basis of partnership property) is amended by inserting before the period “or unless the partnership has a substantial built-in loss immediately after such transfer”.

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

(3) Substantial Built-In Loss.—Section 743 is amended by adding at the end the following new subsection:

“(d) Substantial Built-In Loss.—

“(1) In General.—For purposes of this section, a partnership has a substantial built-in loss with respect to a transfer of an interest in a partnership if—

“(A) the transferee partner’s proportionate share of the adjusted basis of the partnership property exceeds the basis of such partner’s interest in the partnership, and
“(B) such excess exceeds the greater of—

“(i) $250,000, or

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

“(2) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of paragraph (1) and section 734(d), including regulations aggregating related partnerships and disregarding property acquired by the partnership in an attempt to avoid such purposes.”

(4) CLERICAL AMENDMENTS.—

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

“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BUILT-IN LOSS.”

(B) The table of sections for subpart C of part II of subchapter K of chapter 1 is amended by striking the item relating to section 743 and inserting the following new item:

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

(e) ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL BASIS REDUCTION.—
(1) ADJUSTMENT REQUIRED.—Subsection (a) of section 734 (relating to optional adjustment to basis of undistributed partnership property) is amended by inserting before the period “or unless there is a substantial basis reduction”.

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

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

“(d) SUBSTANTIAL BASIS REDUCTION.—

“(1) IN GENERAL.—For purposes of this section, there is a substantial basis reduction with respect to a distribution if the sum of the amounts described in subparagraphs (A) and (B) of subsection (b)(2) exceeds the greater of $250,000 or 10 percent of the aggregate adjusted basis of partnership property immediately after the distribution.

“(2) REGULATIONS.—

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

(4) CLERICAL AMENDMENTS.—

(A) The section heading for section 734 is amended to read as follows:
SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BASIS REDUCTION.

(B) The table of sections for subpart B of part II of subchapter K of chapter 1 is amended by striking the item relating to section 734 and inserting the following new item:

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

(d) EFFECTIVE DATES.—

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

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

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

SEC. 107. MODIFICATIONS OF SUBSTANTIAL UNDERSTATEMENT PENALTY FOR NONREPORTABLE TRANSACTIONS.

(a) SUBSTANTIAL UNDERSTATEMENT OF CORPORATIONS.—Section 6662(d)(1)(B) (relating to special rule for corporations) is amended to read as follows:

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“(B) Special rule for corporations.—In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of—

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

“(ii) $10,000,000.”

(b) Reduction for Understatement of Taxpayer Due to Position of Taxpayer or Disclosed Item.—Section 6662(d)(2)(B)(i) (relating to substantial authority) is amended to read as follows:

“(i) the tax treatment of any item by the taxpayer if the taxpayer had reasonable belief that the tax treatment was more likely than not the proper treatment, or”.

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.
Subtitle B—Promoter-Related Provisions

SEC. 111. DISCLOSURE OF REPORTABLE TRANSACTIONS.

(a) IN GENERAL.—Section 6111 (relating to registration of tax shelters) is amended to read as follows:

“SEC. 6111. DISCLOSURE OF REPORTABLE TRANSACTIONS.

“(a) IN GENERAL.—Each material advisor with respect to any reportable transaction shall make a return (in such form as the Secretary may prescribe) setting forth—

“(1) information identifying and describing the transaction,

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

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

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

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

“(1) MATERIAL ADVISOR.—

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

“(i) who provides any material aid, assistance, or advice with respect to organizing, promoting, selling, implementing,
or carrying out any reportable transaction, and

“(ii) who directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the Secretary) for such advice or assistance.

“(B) Threshold Amount.—For purposes of subparagraph (A), the threshold amount is—

“(i) $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and

“(ii) $250,000 in any other case.

“(2) Reportable Transaction.—The term ‘reportable transaction’ has the meaning given to such term by section 6707A(c).

“(c) Regulations.—The Secretary may prescribe regulations which provide—

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

“(2) exemptions from the requirements of this section, and
“(3) such rules as may be necessary or appropriate to carry out the purposes of this section.”

(b) CONFORMING AMENDMENTS.—

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

“Sec. 6111. Disclosure of reportable transactions.”

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

“SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANSACTIONS MUST KEEP LISTS OF ADVISEES, ETC.

“(a) IN GENERAL.—Each material advisor (as defined in section 6111) with respect to any reportable transaction (as defined in section 6707A(c)) shall (whether or not required to file a return under section 6111 with respect to such transaction) maintain (in such manner as the Secretary may by regulations prescribe) a list—

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

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

(3) Section 6112 is amended—

(A) by redesignating subsection (c) as subsection (b),
(B) by inserting “written” before “request” in subsection (b)(1) (as so redesignated), and

(C) by striking “shall prescribe” in subsection (b)(2) (as so redesignated) and inserting “may prescribe”.

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

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

(5)(A) The heading for section 6708 is amended to read as follows:

“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES WITH RESPECT TO REPORTABLE TRANSACTIONS.”

(B) The item relating to section 6708 in the table of sections for part I of subchapter B of chapter 68 is amended to read as follows:

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

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transactions with respect to which material aid, assistance, or advice referred to in section 6111(b)(1)(A)(i) of the Internal Revenue Code of 1986 (as added by this section) is provided after the date of the enactment of this Act.
SEC. 112. FAILURE TO FURNISH INFORMATION REGARDING REPORTABLE TRANSACTIONS.

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

“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARDING REPORTABLE TRANSACTIONS.

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

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

“(2) files false or incomplete information with the Secretary with respect to such transaction,

such person shall pay a penalty with respect to such return in the amount determined under subsection (b).

“(b) AMOUNT OF PENALTY.—

“(1) IN GENERAL.—Except as provided in paragraph (2), the penalty imposed under subsection (a) with respect to any failure shall be $50,000.

“(2) LISTED TRANSACTIONS.—The penalty imposed under subsection (a) with respect to any listed transaction shall be an amount equal to the greater of—

“(A) $200,000, or
“(B) 50 percent of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return is filed under section 6111. Subparagraph (B) shall be applied by substituting ‘75 percent’ for ‘50 percent’ in the case of an intentional failure or act described in subsection (a).

“(c) Rescission Authority.—The provisions of section 6707A(d) (relating to authority of Commissioner to rescind penalty) shall apply to any penalty imposed under this section.

“(d) Reportable and Listed Transactions.—For purposes of this section, the terms ‘reportable transaction’ and ‘listed transaction’ have the respective meanings given to such terms by section 6707A(e).”

(b) Clerical Amendment.—The item relating to section 6707 in the table of sections for part I of subchapter B of chapter 68 is amended by striking “tax shelters” and inserting “reportable transactions”.

(c) Effective Date.—The amendments made by this section shall apply to returns the due date for which is after the date of the enactment of this Act.
SEC. 113. MODIFICATION OF PENALTY FOR FAILURE TO MAINTAIN LISTS OF INVESTORS.

(a) In General.—Subsection (a) of section 6708 is amended to read as follows:

“(a) Imposition of Penalty.—

“(1) In General.—If any person who is required to maintain a list under section 6112(a) fails to make such list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of such request, such person shall pay a penalty of $10,000 for each day of such failure after such 20th day.

“(2) Reasonable cause exception.—No penalty shall be imposed by paragraph (1) with respect to the failure on any day if such failure is due to reasonable cause.”

(b) Effective Date.—The amendment made by this section shall apply to requests made after the date of the enactment of this Act.

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

(a) In General.—Section 7408 (relating to action to enjoin promoters of abusive tax shelters, etc.) is amended by redesignating subsection (c) as subsection (d) and
by striking subsections (a) and (b) and inserting the fol-
lowing new subsections:

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

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

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

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

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

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

(b) **Conforming Amendments.—**

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

“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RELATED TO TAX SHELTERS AND REPORTABLE TRANSACTIONS.”

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

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

(c) **Effective Date.**—The amendment made by this section shall take effect on the day after the date of the enactment of this Act.

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

(a) **In General.**—Section 5321(a)(5) of title 31, United States Code, is amended to read as follows:

“(5) **Foreign Financial Agency Transaction Violation.**—

“(A) **Penalty Authorized.**—The Secretary of the Treasury may impose a civil money penalty on any person who violates, or
causes any violation of, any provision of section 5314.

“(B) AMOUNT OF PENALTY.—

“(i) IN GENERAL.—Except as pro-

vided in subparagraph (C), the amount of

any civil penalty imposed under subpara-

graph (A) shall not exceed $5,000.

“(ii) REASONABLE CAUSE EXCEP-

TION.—No penalty shall be imposed under

subparagraph (A) with respect to any vio-

lation if—

“(I) such violation was due to

reasonable cause, and

“(II) the amount of the trans-

action or the balance in the account

at the time of the transaction was

properly reported.

“(C) WILLFUL VIOLATIONS.—In the case

of any person willfully violating, or willfully

causing any violation of, any provision of sec-

tion 5314—

“(i) the maximum penalty under sub-

paragraph (B)(i) shall be increased to the

greater of—

“(I) $25,000, or
“(II) the amount (not exceeding $100,000) determined under subparagraph (D), and
“(ii) subparagraph (B)(ii) shall not apply.
“(D) AMOUNT.—The amount determined under this subparagraph is—
“(i) in the case of a violation involving a transaction, the amount of the transaction, or
“(ii) in the case of a violation involving a failure to report the existence of an account or any identifying information required to be provided with respect to an account, the balance in the account at the time of the violation.”

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

SEC. 116. FRIVOLOUS TAX SUBMISSIONS.

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

“SEC. 6702. FRIVOLOUS TAX SUBMISSIONS.

“(a) CIVIL PENALTY FOR FRIVOLOUS TAX RETURNS.—A person shall pay a penalty of $5,000 if—
“(1) such person files what purports to be a return of a tax imposed by this title but which—

“(A) does not contain information on which the substantial correctness of the self-assessment may be judged, or

“(B) contains information that on its face indicates that the self-assessment is substantially incorrect; and

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

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

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

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

“(1) IMPOSITION OF PENALTY.—Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of $5,000.

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

“(A) SPECIFIED FRIVOLOUS SUBMISSION.—The term ‘specified frivolous submission’ means a specified submission if any portion of such submission—
“(i) is based on a position which is frivolous, or

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

“(B) Specified Submission.—The term ‘specified submission’ means—

“(i) a request for a hearing under—

“(I) section 6320 (relating to notice and opportunity for hearing upon filing of notice of lien), or

“(II) section 6330 (relating to notice and opportunity for hearing before levy), and

“(ii) an application under—

“(I) section 6159 (relating to agreements for payment of tax liability in installments),

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

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

“(3) Opportunity to Withdraw Submission.—If the Secretary provides a person with notice that a submission is a specified frivolous sub-
mission and such person withdraws such submission within 30 days after such notice, the penalty imposed under paragraph (1) shall not apply with respect to such submission.

“(c) REDUCTION OF PENALTY.—The Secretary may reduce the amount of any penalty imposed under this section if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws.

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

(b) Clerical Amendment.—The table of sections for part I of subchapter B of chapter 68 is amended by striking the item relating to section 6702 and inserting the following new item:

“Sec. 6702. Frivolous tax submissions.”

(c) Effective Date.—The amendments made by this section shall apply to submissions made and issues raised after the date of the enactment of this Act.

SEC. 117. REGULATION OF INDIVIDUALS PRACTICING BEFORE THE DEPARTMENT OF THE TREASURY.

(a) Censure; Imposition of Penalty.—

(1) IN GENERAL.—Section 330(b) of title 31, United States Code, is amended—
(A) by inserting “, or censure,” after “Department”, and
(B) by adding at the end the following new flush sentence:

“The Secretary may impose a monetary penalty on any representative described in the preceding sentence. If the representative was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to such penalty, the Secretary may impose a monetary penalty on such employer, firm, or entity if it knew, or reasonably should have known, of such conduct. Such penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty and may be in addition to, or in lieu of, any suspension, disbarment, or censure.”

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

(b) TAX SHELTER OPINIONS, ETC.—Section 330 of such title 31 is amended by adding at the end the following new subsection:

“(d) Nothing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity,
transaction plan or arrangement, or other plan or arrange-
ment, which is of a type which the Secretary determines
as having a potential for tax avoidance or evasion.”

SEC. 118. PENALTY ON PROMOTERS OF TAX SHELTERS.

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

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

Subtitle C—Other Provisions

SEC. 121. TREATMENT OF STRIPPED INTERESTS IN BOND
AND PREFERRED STOCK FUNDS, ETC.

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

“(f) TREATMENT OF STRIPPED INTERESTS IN BOND
AND PREFERRED STOCK FUNDS, ETC.—In the case of an
account or entity substantially all of the assets of which consist of bonds, preferred stock, or a combination thereof, the Secretary may by regulations provide that rules similar to the rules of this section and 305(e), as appropriate, shall apply to interests in such account or entity to which (but for this subsection) this section or section 305(e), as the case may be, would not apply.”

(b) Cross Reference.—Subsection (e) of section 305 is amended by adding at the end the following new paragraph:

“(7) Cross reference.—

“For treatment of stripped interests in certain accounts or entities holding preferred stock, see section 1286(f).”

(c) Effective Date.—The amendments made by this section shall apply to purchases and dispositions after the date of the enactment of this Act.

SEC. 122. MINIMUM HOLDING PERIOD FOR FOREIGN TAX CREDIT ON WITHHOLDING TAXES ON INCOME OTHER THAN DIVIDENDS.

(a) In General.—Section 901 is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

“(l) Minimum Holding Period for Withholding Taxes on Gain and Income Other than Dividends Etc.—
“(1) In general.—In no event shall a credit be allowed under subsection (a) for any withholding tax (as defined in subsection (k)) on any item of income or gain with respect to any property if—

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

“(B) to the extent that the recipient of the item is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

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

“(2) Exception for taxes paid by dealers.—

“(A) In general.—Paragraph (1) shall not apply to any qualified tax with respect to any property held in the active conduct in a foreign country of a business as a dealer in such property.

“(B) Qualified tax.—For purposes of subparagraph (A), the term ‘qualified tax’
means a tax paid to a foreign country (other than the foreign country referred to in subpara-
graph (A)) if—

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

“(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other for-

eign country.

“(C) DEALER.—For purposes of subpara-

graph (A), the term ‘dealer’ means—

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

“(ii) with respect to any other prop-

erty, any person with respect to whom such property is described in section 1221(a)(1).

“(D) REGULATIONS.—The Secretary may prescribe such regulations as may be appro-

priate to carry out this paragraph, including
regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

“(3) EXCEPTIONS.—The Secretary may by regulation provide that paragraph (1) shall not apply to property where the Secretary determines that the application of paragraph (1) to such property is not necessary to carry out the purposes of this subsection.

“(4) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (k) shall apply for purposes of this subsection.

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

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

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or accrued more than 30 days after the date of the enactment of this Act.
SEC. 123. AFFIRMATION OF CONSOLIDATED RETURN REGULATION AUTHORITY.

(a) In General.—Section 1502 is amended by adding at the end the following new sentence: “In carrying out the preceding sentence, the Secretary may prescribe rules that are different from the provisions of chapter 1 that would apply if such corporations filed separate returns.”.

(b) Result Not Overturned.—Notwithstanding the amendment made by subsection (a), the Internal Revenue Code of 1986 shall be construed by treating Treasury Regulation § 1.1502-20(c)(1)(iii) (as in effect on January 1, 2001) as being inapplicable to the factual situation in Rite Aid Corporation and Subsidiary Corporations v. United States, 255 F.3d 1357 (Fed. Cir. 2001).

(c) Effective Date.—This section, and the amendment made by this section, shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.
TITLE II—PROVISIONS TO REDUCE TAX AVOIDANCE THROUGH CORPORATE EARNINGS STRIPPING AND EXPATRIATION

SEC. 201. REDUCTION IN POTENTIAL FOR EARNINGS STRIPPING BY FURTHER LIMITING DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS.

(a) REDUCTION IN POTENTIAL FOR EARNINGS STRIPPING.—

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

“(1) LIMITATION.—

“(A) IN GENERAL.—In the case of a corporation, no deduction shall be allowed under this chapter for disqualified interest paid or accrued during the taxable year.

“(B) MAXIMUM DISALLOWANCE.—

“(i) IN GENERAL.—Except as provided in clause (ii), the amount disallowed under subparagraph (A) shall not exceed the corporation’s excess overall interest expense for the taxable year.

“(ii) CORPORATIONS WHICH ARE MEMBERS OF WORLDWIDE AFFILIATED
GROUP.—In the case of a corporation which is a member of a worldwide affiliated group, the amount disallowed under subparagraph (A) shall not exceed the greater of—

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

“(II) the corporation’s excess domestic disqualified interest for such year.

“(C) DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year and in the 2nd through 5th succeeding taxable years to the extent not previously taken into account under this subparagraph. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed—

“(i) the excess (if any) of—

“(I) 35 percent of the adjusted taxable income of the corporation for such succeeding taxable year, over
“(II) the corporation’s net interest expense for such succeeding taxable year, reduced by

“(ii) amounts carried to such succeeding taxable year from taxable years preceding the taxable year from which the amount is being carried forward.

“(D) SPECIAL RULES FOR CARRYOVER.—

“(i) NO CARRYOVER OF EXCESS DOMESTIC DISQUALIFIED INTEREST.—In the case of a corporation which is a member of a worldwide affiliated group, the amount disallowed under subparagraph (A) for any taxable year which may be treated as provided in subparagraph (C) shall not exceed the excess (if any) of the amount disallowed over the amount described in subparagraph (B)(ii)(II) for such year.

“(ii) NO CARRYOVER TO YEAR FOR WHICH AMOUNT DISALLOWED.—No amount may be carried under this subparagraph to any taxable year for which any amount is disallowed under subparagraph (A).
“(2) Excess interest expense.—For purposes of this subsection—

“(A) Excess overall interest expense.—The term ‘excess overall interest expense’ means the excess (if any) of—

“(i) the corporation’s net interest expense, over

“(ii) 35 percent of the adjusted taxable income of the corporation.

“(B) Excess domestic disqualified interest.—The term ‘excess domestic disqualified interest’ means the product of—

“(i) the disqualified interest paid or accrued by the corporation during the taxable year, and

“(ii) the corporation’s disproportionate domestic related-party indebtedness percentage.”

(2) Disproportionate domestic related-party indebtedness percentage.—Subsection (j) of section 163 is amended by redesignating paragraphs (6), (7), and (8) as paragraphs (7), (8), and (9), respectively, and by inserting after paragraph (5) the following new paragraph:
“(6) Disproportionate Domestic Related-Party Indebtedness Percentage.—For purposes of this subsection—

“(A) In General.—The term ‘disproportionate domestic related-party indebtedness percentage’ means, for any taxable year, the percentage (but not greater than 100 percent) which, as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe)—

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

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

“(B) Disproportionate Indebtedness.—The term ‘disproportionate indebtedness’ means the amount by which the total indebtedness of the corporation exceeds the amount which bears the same ratio to the total indebtedness of the worldwide affiliated group as—

“(i) the money and all other assets of the corporation, bears to
“(ii) the money and all other assets of
the worldwide affiliated group of which
such corporation is a member.

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

“(C) Related-party indebtedness.—
The term ‘related-party indebtedness’ means
any indebtedness of the corporation if the inter-
est on such indebtedness is disqualified interest.

“(D) Worldwide affiliated group.—
“(i) In general.—Except as pro-
vided in clause (ii), the term ‘worldwide af-
iliated group’ means an affiliated group as
defined in section 1504(a), determined
without regard to paragraphs (2), (3), and
(4) of section 1504(b).

“(ii) Treatment of certain finan-
cial institutions.—
“(I) In general.—All financial
corporations (as defined in section
864(e)(6)(B)) which are members of a
worldwide affiliated group shall be
treated as a separate worldwide affiliated group (and not as part of any other worldwide affiliated group) for purposes of applying this subsection.

"(II) Determination of Domestic Debt and Assets.—For purposes of this paragraph, all such financial corporations which are members of the same affiliated group (as defined in section 1504(a), determined without regard to paragraph (2) of section 1504(b)) shall be treated as 1 corporation.

"(E) Determination of Debt and Assets.—For purposes of this paragraph—

"(i) the amount taken into account with respect to any asset shall be the adjusted basis thereof for purposes of determining gain,

"(ii) the amount taken into account with respect to any indebtedness with original issue discount shall be its issue price plus the portion of the original issue discount previously accrued as determined under the rules of section 1272 (deter-
mined without regard to subsection (a)(7) or (b)(4) thereof, and

“(iii) there shall be such other adjustments as the Secretary may by regulations prescribe.”

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

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

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

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

“(m) LIMITATION ON DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS OF TAXABLE REIT SUBSIDIARY.—

“(1) LIMITATION.—

“(A) IN GENERAL.—If this subsection applies to any taxable REIT subsidiary for any taxable year, no deduction shall be allowed
under this chapter for disqualified interest paid
or accrued by such subsidiary during such taxable year. The amount disallowed under the preceding sentence shall not exceed the subsidiary’s excess interest expense for the taxable year.

“(B) Disallowed amount carried to succeeding taxable year.—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year (and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated).

“(2) Subsidiaries to which subsection applies.—

“(A) In general.—This subsection shall apply to any taxable REIT subsidiary for any taxable year if—

“(i) such subsidiary has excess interest expense for such taxable year, and

“(ii) the ratio of debt to equity of such subsidiary as of the close of such taxable year (or on any other day during the
taxable year as the Secretary may by regu-
lations prescribe) exceeds 1.5 to 1.

“(B) EXCESS INTEREST EXPENSE.—

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

“(I) the taxable REIT subsi-
dary’s net interest expense, over

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

“(ii) EXCESS LIMITATION
CARRYFORWARD.—If a taxable REIT sub-
sidiary has an excess limitation for any
taxable year, the amount of such excess
limitation shall be an excess limitation
carryforward to the 1st succeeding taxable
year and to the 2nd and 3rd succeeding
taxable years to the extent not previously
taken into account under this clause. The
amount of such a carryforward taken into
account for any such succeeding taxable
year shall not exceed the excess interest
expense for such succeeding taxable year
(determined without regard to the
carryforward from the taxable year of such
excess limitation).

“(iii) Excess limitation.—For pur-
poses of clause (ii), the term ‘excess limita-
tion’ means the excess (if any) of—

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

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

“(C) Ratio of debt to equity.—For
purposes of this paragraph, the term ‘ratio of
debt to equity’ means the ratio which the total
indebtedness of the subsidiary bears to the sum
of its money and all other assets reduced (but
not below zero) by such total indebtedness. The
rules of section 163(j)(6)(E) shall apply for
purposes of the preceding sentence.

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

“(4) Other rules to apply.—Rules similar
to the rules of paragraphs (7), (8), and (9) of sec-
tion 163(j) shall apply for purposes of this sub-
section.”

(c) Effective Date.—

(1) In General.—Except as otherwise pro-
vided in this subsection, the amendments made by
this section shall apply to taxable years beginning

(2) Earlier Effective Date with Respect
to Expatriated Corporations, Etc.—The
amendments made by this section shall apply to tax-
able years ending after March 20, 2002, in the case
of a taxpayer which is—

(A) a surrogate foreign corporation, as de-
defined in section 7874(b) of the Internal Rev-

venue Code of 1986 (as added by section 202),

(B) a corporation which would be a surro-
gate foreign corporation (as so defined) if “De-

cember 31, 1996” were substituted for “March

20, 2002” in such section 7874(b), and

(C) any corporation which is an expatri-
ated entity (as defined in such section 7874(b))

with respect to a corporation described in sub-
paragraph (A) or (B).

(3) Earlier Effective Date for Recent
Debt.—
(A) In general.—Subject to subparagraph (B), the amendments made by this section shall also apply to taxable years ending after July 10, 2002, and beginning before the first taxable year to which such amendments would (without regard to this paragraph) apply.

(B) Application only to recent debt.—In the case of a taxable year to which the amendments made by this section apply solely by reason of this paragraph, the increase in the amount disallowed under section 163(j) of the Internal Revenue Code of 1986 by reason of such amendments shall not exceed the amount of disqualified interest for such year on indebtedness incurred after July 10, 2002.

(4) Limitation on carryover of disallowed interest.—For purposes of applying section 163(j)(1)(C) of the Internal Revenue Code of 1986 (as added by this section), amounts carried to any taxable year beginning after December 31, 2003, shall be treated as disallowed for the most recent taxable year beginning on or before such date.
SEC. 202. TAX TREATMENT OF EXPATRIATED ENTITIES AND THEIR FOREIGN PARENTS.

(a) In General.—Subchapter C of chapter 80 (relating to provisions affecting more than one subtitle) is amended by adding at the end the following new section:

"SEC. 7874. RULES RELATING TO EXPATRIATED ENTITIES AND THEIR FOREIGN PARENTS.

"(a) Inverted Corporations Treated as Domestic Corporations.—

"(1) In General.—If a foreign incorporated entity is treated as an inverted domestic corporation, then, notwithstanding section 7701(a)(4), such entity shall be treated for purposes of this title as a domestic corporation.

"(2) Exception.—Paragraph (1) shall not apply for purposes of determining under section 367 whether any shareholder recognizes gain in connection with the acquisition.

"(3) Inverted Domestic Corporation.—For purposes of this section, a foreign incorporated entity shall be treated as an inverted domestic corporation if, pursuant to a plan (or a series of related transactions)—

"(A) the entity completes after March 20, 2002, the direct or indirect acquisition of substantially all of the properties held directly or
indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership,

“(B) after the acquisition at least 80 percent of the stock (by vote or value) of the entity is held—

“(i) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or

“(ii) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership, and

“(C) the expanded affiliated group which after the acquisition includes the entity does not have substantial business activities in the foreign country in which or under the law of which the entity is created or organized when compared to the total business activities of such expanded affiliated group.
“(4) TERMINATION.—This subsection shall not apply to any acquisition completed after March 20, 2005.

“(b) TAX ON INVERSION GAIN OF EXPATRIATED ENTITIES.—

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

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

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

“(i) the domestic corporation or partnership referred to in subparagraph (B)(i) with respect to which a foreign incorporated entity is a surrogate foreign corporation, and

“(ii) any United States person who is related (within the meaning of section 267(b) or 707(b)(1)) to a domestic corporation or partnership described in clause (i).
“(B) Surrogate foreign corporation.—A foreign incorporated entity shall be treated as a surrogate foreign corporation if, pursuant to a plan (or a series of related transactions)—

“(i) the entity completes after March 20, 2002, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership, and

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

“(I) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or

“(II) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of hold-
ing a capital or profits interest in the domestic partnership.

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

“(c) General Definitions and Special Rules.—

“(1) Foreign Incorporated Entity.—For purposes of this section, the term ‘foreign incorporated entity’ means any entity which is, or but for subsection (a) would be, treated as a foreign corporation for purposes of this title.

“(2) Expanded Affiliated Group.—The term ‘expanded affiliated group’ means an affiliated group as defined in section 1504(a) but without regard to section 1504(b), except that section 1504(a) shall be applied by substituting ‘more than 50 percent’ for ‘at least 80 percent’ each place it appears.

“(3) Certain Stock Disregarded.—There shall not be taken into account in determining ownership under subsections (a)(3)(B) and (b)(2)(B)(ii)—

“(i) stock held by members of the expanded affiliated group which includes the foreign incorporated entity, or

“(ii) stock of such foreign incorporated entity which is sold in a public of-
fering related to the acquisition described in subsection (a)(3)(A) or (b)(2)(B)(i), respectively.

“(4) Plan deemed in certain cases.—If a foreign incorporated entity acquires directly or indirectly substantially all of the properties of a domestic corporation or partnership during the 4-year period beginning on the date which is 2 years before the ownership requirements of subsections (a)(3)(B) and (b)(2)(B)(ii) are met, such actions shall be treated as pursuant to a plan.

“(5) Certain transfers disregarded.—The transfer of properties or liabilities (including by contribution or distribution) shall be disregarded if such transfers are part of a plan a principal purpose of which is to avoid the purposes of this section.

“(6) Special rule for related partnerships.—For purposes of applying subsections (a)(3)(B) and (b)(2)(B)(ii) to the acquisition of a domestic partnership, except as provided in regulations, all partnerships which are under common control (within the meaning of section 482) shall be treated as 1 partnership.

“(7) Regulations.—The Secretary shall prescribe such regulations as may be appropriate to de-
termine whether a corporation is an inverted domes-
tic corporation or surrogate foreign corporation, in-
cluding regulations—

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

“(B) to treat stock as not stock.

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

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

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

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

“(2) INVERSION GAIN.—The term ‘inversion
gain’ means the income or gain recognized by reason
of the transfer during the applicable period of stock
or other properties by an expatriated entity, and any
income received or accrued during the applicable pe-
riod by reason of a license of any property by an ex-
patriated entity —
“(A) as part of the acquisition described in subsection (b)(2)(B)(i), or

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

Subparagraph (B) shall not apply to property described in section 1221(a)(1) in the hands of the expatriated entity.

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

“(A) is related (within the meaning of section 267(b) or 707(b)(1)) to such entity, or

“(B) is under the same common control (within the meaning of section 482) as such entity.

“(e) SPECIAL RULES RELATING TO TAX ON INVERSION GAIN.—

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

“(A) the amount of the inversion gain for the taxable year, and
“(B) the highest rate of tax specified in section 11(b)(1).

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

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

“(A) subsection (b) shall apply at the partner rather than the partnership level,

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

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

“(ii) gain recognized for the taxable year by the partner by reason of the transfer during the applicable period of any partnership interest of the partner in such partnership to the surrogate foreign corporation, and

“(C) the highest rate of tax specified in the rate schedule applicable to the partner under this chapter shall be substituted for the rate of tax referred to in paragraph (1).
“(3) **COORDINATION WITH SECTION 172 AND MINIMUM TAX.**—Rules similar to the rules of paragraphs (3) and (4) of section 860E(a) shall apply for purposes of subsection (b).

“(4) **STATUTE OF LIMITATIONS.—**

“(A) **IN GENERAL.**—The statutory period for the assessment of any deficiency attributable to the inversion gain of any taxpayer for any pre-inversion year shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of the acquisition described in subsection (b)(2)(B)(i) to which such gain relates and such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

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

“(i) any portion of the applicable period is included in such taxable year, and
“(ii) such year ends before the taxable
year in which the acquisition described in
subsection (b)(2)(B)(i) is completed.

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

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

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

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

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

“Sec. 7874. Rules relating to expatriated entities and their for-
eign parents.”
(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after March 20, 2002.

SEC. 203. EXCISE TAX ON STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS.

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

“CHAPTER 48—STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS

“Sec. 5000A. Stock compensation of insiders in expatriated corporations.

“SEC. 5000A. STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS.

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

“(b) VALUE.—For purposes of subsection (a)—
“(1) IN GENERAL.—The value of specified stock compensation shall be—

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

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

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

“(A) in the case of specified stock compensation held on the expatriation date, on such date,

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

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

“(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN RECOGNIZED.—Subsection (a) shall apply to any disqualified individual with respect to an expatriated corporation only if gain (if any) on any stock in such corporation is recognized in whole or part by any shareholder by reason of the acquisition referred to in section 7874(b)(2)(B)(i)
(d) Exception Where Gain Recognized on Compensation.—Subsection (a) shall not apply to—

(1) any stock option which is exercised on the expatriation date or during the 6-month period before such date and to the stock acquired in such exercise, and

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

(e) Definitions.—For purposes of this section—

(1) Disqualified Individual.—The term 'disqualified individual' means, with respect to a corporation, any individual who, at any time during the 12-month period beginning on the date which is 6 months before the expatriation date—

(A) is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to such corporation or any member of the expanded affiliated group which includes such corporation, or

(B) would be subject to such requirements if such corporation or member were an
issuer of equity securities referred to in such section.

“(2) EXPATRIATED CORPORATION; EXPATRIATION DATE.—

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

“(i) section 7874(b)(2)(B) were applied by substituting ‘July 10, 2002’ for ‘March 20, 2002’, and

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

Such term includes any predecessor or successor of such a corporation.

“(B) EXPATRIATION DATE.—The term ‘expatriation date’ means, with respect to a corporation, the date on which the corporation first becomes an expatriated corporation.

“(3) SPECIFIED STOCK COMPENSATION.—

“(A) IN GENERAL.—The term ‘specified stock compensation’ means payment (or right to payment) granted by the expatriated corporation (or by any member of the expanded affiliated group which includes such corporation)
to any person in connection with the perform-
ance of services by a disqualified individual for
such corporation or member if the value of such
payment or right is based on (or determined by
reference to) the value (or change in value) of
stock in such corporation (or any such mem-
ber).

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

“(i) any option to which part II of
subchapter D of chapter 1 applies, or
“(ii) any payment or right to payment
from a plan referred to in section
280G(b)(6).

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

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

“(1) CANCELLATION OF RESTRICTION.—The
cancellation of a restriction which by its terms will
never lapse shall be treated as a grant.
“(2) Payment or reimbursement of tax by corporation treated as specified stock compensation.—Any payment of the tax imposed by this section directly or indirectly by the expatriated corporation or by any member of the expanded affiliated group which includes such corporation—

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

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

“(3) Certain restrictions ignored.— Whether there is specified stock compensation, and the value thereof, shall be determined without regard to any restriction other than a restriction which by its terms will never lapse.

“(4) Property transfers.—Any transfer of property shall be treated as a payment and any right to a transfer of property shall be treated as a right to a payment.

“(5) Other administrative provisions.— For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A.
“(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.”

(b) DENIAL OF DEDUCTION.—

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

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

“(G) COORDINATION WITH EXCISE TAX ON SPECIFIED STOCK COMPENSATION.—The dollar limitation contained in paragraph (1) with respect to any covered employee shall be reduced (but not below zero) by the amount of any payment (with respect to such employee) of the tax imposed by section 5000A directly or indirectly by the expatriated corporation (as defined in such section) or by any member of the expanded affiliated group (as defined in such section) which includes such corporation.”

(e) CONFORMING AMENDMENTS.—

(1) The last sentence of section 3121(v)(2)(A) is amended by inserting before the period “or to any
specified stock compensation (as defined in section 5000A) on which tax is imposed by section 5000A”.

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

“Chapter 48. Stock compensation of insiders in expatriated corporations.”

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

SEC. 204. REPORTING OF TAXABLE MERGERS AND ACQUISITIONS.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6043 the following new section:

“SEC. 6043A. TAXABLE MERGERS AND ACQUISITIONS.

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

“(1) a description of the acquisition,
“(2) the name and address of each shareholder
of the acquired corporation who is required to recog-
nize gain (if any) as a result of the acquisition,
“(3) the amount of money and the fair market
value of other property transferred to each such
shareholder as part of such acquisition, and
“(4) such other information as the Secretary
may prescribe.
To the extent provided by the Secretary, the requirements
of this section applicable to the acquiring corporation shall
be applicable to the acquired corporation and not to the
acquiring corporation.
“(b) Nominee Reporting.—Any person who holds
stock as a nominee for another person shall furnish in the
manner prescribed by the Secretary to such other person
the information provided by the corporation under sub-
section (d).
“(c) Taxable Acquisition.—For purposes of this
section, the term ‘taxable acquisition’ means any acquisi-
tion by a corporation of stock in or property of another
corporation if any shareholder of the acquired corporation
is required to recognize gain (if any) as a result of such
acquisition.
“(d) Statements to Be Furnished to Share-
holders.—Every person required to make a return under
subsection (a) shall furnish to each shareholder whose name is required to be set forth in such return a written statement showing—

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

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

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

The written statement required under the preceding sentence shall be furnished to the shareholder on or before January 31 of the year following the calendar year during which the taxable acquisition occurred.”

(b) ASSESSABLE PENALTIES.—

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

“(ii) section 6043A(a) (relating to returns relating to taxable mergers and acquisitions),”.

(2) Paragraph (2) of section 6724(d) is amended by redesignating subparagraphs (F) through
(AA) as subparagraphs (G) through (BB), respectively, and by inserting after subparagraph (E) the following new subparagraph:

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

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

“Sec. 6043A. Returns relating to taxable mergers and acquisitions.”.

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

SEC. 205. STUDIES.

(a) TRANSFER PRICING RULES.—The Secretary of the Treasury or the Secretary’s delegate shall conduct a study regarding the effectiveness of current transfer pricing rules and compliance efforts in ensuring that cross-border transfers and other related-party transactions, particularly transactions involving intangible assets, service contracts, or leases cannot be used improperly to shift income out of the United States. The study shall include a review of the contemporaneous documentation and penalty rules under section 6662 of the Internal Revenue
Code of 1986, a review of the regulatory and administrative guidance implementing the principles of section 482 of such Code to transactions involving intangible property and services and to cost-sharing arrangements and an examination of whether increased disclosure of cross-border transactions should be required. The study shall set forth specific recommendations to address all abuses identified in the study. Not later than December 31, 2002, such Secretary or delegate shall submit to the Congress a report of such study.

(b) INCOME TAX TREATIES.—The Secretary of the Treasury or the Secretary’s delegate shall conduct a study of United States income tax treaties to identify any inappropriate reductions in United States withholding tax that provide opportunities for shifting income out of the United States, and to evaluate whether existing anti-abuse mechanisms are operating properly. The study shall include specific recommendations to address all inappropriate uses of tax treaties. Not later than December 31, 2002, such Secretary or delegate shall submit to the Congress a report of such study.

(c) IMPACT OF EXPATRIATION PROVISIONS.—The Secretary of the Treasury or the Secretary’s delegate shall conduct a study of the impact of the provisions of this title on corporate earnings stripping and expatriation. The
study shall include such recommendations as such Sec-
retary or delegate may have to improve the impact of such
provisions in carrying out the purposes of this title. Not
later than December 31, 2004, such Secretary or delegate
shall submit to the Congress a report of such study.

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

Subtitle A—Treatment of
Controlled Foreign Corporations

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

(a) In General.—Subsection (a) of section 954 (re-
lating to foreign base company income) is amended by
striking paragraphs (2) and (3) and by redesignating
paragraphs (4) and (5) as paragraphs (2) and (3), respec-
tively.

(b) Certain Sales.—Paragraph (1) of section
954(c) is amended by adding at the end the following new
subparagraph:

“(H) Certain sales.—Income (whether
in the form of profits, commissions, fees, or
otherwise) derived in connection with the pur-
chase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where—

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

“(ii) the property is sold for use, consumption, or disposition in the United States, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition in the United States.”

(c) CONFORMING AMENDMENTS.—

(1) Clause (iii) of section 952(c)(1)(B) is amended by striking subclauses (III) and (IV) and by redesignating subclauses (V) and (VI) as subclauses (III) and (IV), respectively.
(2) Section 953(c)(6)(A) is amended by striking “section 954(d)(3)” and inserting “section 954(b)(9)”.

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

“(9) RELATED PERSON DEFINED.—For purposes of this subsection, a person is a related person with respect to a controlled foreign corporation if—

“(A) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

“(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power of all classes of stock entitled to vote or of the total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of more than 50 percent (by value) of the beneficial interests in such partnership,
trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply.”

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

(5) Section 954 is amended by striking subsections (d) and (e).

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

SEC. 302. LOOK-THRU TREATMENT OF PAYMENTS BETWEEN RELATED CONTROLLED FOREIGN CORPORATIONS UNDER FOREIGN PERSONAL HOLDING COMPANY INCOME RULES.

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

“(4) LOOK-THRU IN THE CASE OF RELATED CONTROLLED FOREIGN CORPORATIONS.—For purposes of this subsection, dividends, interest, rents, and royalties received from a controlled foreign corporation which is a related person (as defined in subsection (b)(9)) shall not be treated as foreign
personal holding company income to the extent attributable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is not subpart F income (as defined in section 952).”

SEC. 303. LOOK-THRU TREATMENT FOR SALES OF PARTNERSHIP INTERESTS.

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

“(5) Look-through rule for certain partnership sales.—

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

“(B) 25-percent owner.—For purposes of this paragraph, the term ‘25-percent owner’ means a controlled foreign corporation which owns 25 percent or more of the capital or profits interest in the partnership. The constructive
ownership rules of section 958(b) shall apply
for purposes of the preceding sentence.”

SEC. 304. REPEAL OF FOREIGN PERSONAL HOLDING COM-
PANY RULES AND FOREIGN INVESTMENT
COMPANY RULES.

(a) General Rule.—The following provisions are
hereby repealed:

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

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

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

(b) Exemption of Foreign Corporations From
Personal Holding Company Rules.—

(1) In General.—Subsection (c) of section
542 (relating to exceptions) is amended—

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

“(5) a foreign corporation,”,

(B) by striking paragraphs (7) and (10)
and by redesignating paragraphs (8) and (9) as
paragraphs (7) and (8), respectively,
(C) by inserting “and” at the end of paragraph (7) (as so redesignated), and

(D) by striking “; and” at the end of paragraph (8) (as so redesignated) and inserting a period.

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

“(H) PERSONAL SERVICE CONTRACTS.—

“(i) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

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

This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the out-
standing stock of the corporation is owned, di-
rectly or indirectly, by or for the individual who
has performed, is to perform, or may be des-
ignated (by name or by description) as the one
to perform, such services.”

(c) CONFORMING AMENDMENTS.—

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

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

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

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

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

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

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

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

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

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

(9) Section 563 is amended—

(A) by striking subsection (c),

(B) by redesignating subsection (d) as subsection (c), and

(C) by striking “subsection (a), (b), or (c)” in subsection (c) (as so redesignated) and inserting “subsection (a) or (b)”.

(10) Subsection (d) of section 751 is amended by adding “and” at the end of paragraph (2), by striking paragraph (3), by redesignating paragraph (4) as paragraph (3), and by striking “paragraph
(1), (2), or (3)” in paragraph (3) (as so redesignated) and inserting “paragraph (1) or (2)”.

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

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

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

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

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

“(3) UNITED STATES SHAREHOLDER.—The term ‘United States shareholder’ has the meaning given to such term by section 951(b), except that, in the case of a foreign corporation having related person insurance income (as defined in section 953(c)(2)), the Secretary may treat any person as a United States shareholder for purposes of this section if such person is treated as a United States shareholder under section 953(c)(1).”
(D) Subsection (c) of section 898 is amended to read as follows:

“(c) Determination of Required Year.—

“(1) In general.—The required year is—

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

or

“(B) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations.

“(2) 1-Month Deferral Allowed.—A specified foreign corporation may elect, in lieu of the taxable year under paragraph (1)(A), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.

“(3) Majority U.S. Shareholder Year.—

“(A) In general.—For purposes of this subsection, the term ‘majority U.S. shareholder year’ means the taxable year (if any) which, on each testing day, constituted the taxable year of—

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

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

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

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

“(ii) the days during such representative period as the Secretary may prescribe.”

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

“(ii) CERTAIN AMOUNTS INCLUDED.—Except as provided in clause (iii), the term ‘passive income’ includes, except as provided in subparagraph (E)(iii) or paragraph (3)(I), any amount includible in gross income under section 1293 (relating to certain passive foreign investment companies).”

(14)(A) Subparagraph (A) of section 904(g)(1) is amended by adding “or” at the end of clause (i), by striking clause (ii), and by redesignating clause (iii) as clause (ii).
(B) The paragraph heading of paragraph (2) of section 904(g) is amended by striking “FOREIGN PERSONAL HOLDING OR”.

(15) Section 951 is amended by striking subsections (c) and (d) and by redesignating subsections (e) and (f) as subsections (c) and (d), respectively.

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

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

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

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

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

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

“(B) for which it is a real estate investment trust (as defined in section 856).”
(B) The amendment made by subparagraph (A) shall apply to taxable years beginning after December 31, 2004.

(20) Section 1223 is amended by striking paragraph (10) and by redesignating the following paragraphs accordingly.

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

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

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

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

“(2) Election not permitted where amounts otherwise includible under section 951.—The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if any amount
is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.”

(25) Section 6035 is hereby repealed.

(26) Subparagraph (D) of section 6103(e)(1) is amended by striking clause (iv) and redesignating clauses (v) and (vi) as clauses (iv) and (v), respectively.

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

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

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

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

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

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

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

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

SEC. 305. CLARIFICATION OF TREATMENT OF PIPELINE
TRANSPORTATION INCOME.

Section 954(g)(1) (defining foreign base company oil
related income) is amended by striking “or” at the end
of subparagraph (A), by striking the period at the end
of subparagraph (B) and inserting “, or”, and by inserting
after subparagraph (B) the following new subparagraph:
“(C) the pipeline transportation of oil or
gas within such foreign country.”
SEC. 306. DETERMINATION OF FOREIGN PERSONAL HOLDING COMPANY INCOME WITH RESPECT TO TRANSACTIONS IN COMMODITIES.

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

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

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

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

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

“(A) COMMODITY HEDGING TRANSACTIONS.—For purposes of paragraph (1)(C)(i), the term ‘commodity hedging transaction’ means any transaction with respect to a commodity if such transaction—
“(i) is a hedging transaction as defined in section 1221(b)(2), determined—

“(I) without regard to subparagraph (A)(ii) thereof,

“(II) by applying subparagraph (A)(i) thereof by substituting ‘ordinary property or property described in section 1231(b)’ for ‘ordinary property’, and

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

“(ii) is clearly identified as such in accordance with section 1221(a)(7).

“(B) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (1)(C) in the case of transactions involving related parties.”

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

SEC. 307. EFFECTIVE DATE.

Except as otherwise provided in this subtitle, the amendments made by this subtitle shall apply to taxable
years of foreign corporations beginning after December 31, 2002, and taxable years of United States persons owning stock in such corporations with or within which such corporations’ taxable years end.

Subtitle B—Provisions Relating to Foreign Tax Credit

SEC. 311. INTEREST EXPENSE ALLOCATION RULES.

(a) Allocation on Worldwide Basis.—

(1) In general.—Paragraphs (1) and (2) of section 864(e) (relating to rules for allocating interest, etc.) are amended to read as follows:

“(1) Allocation and apportionment of interest expense.—

“(A) In general.—The taxable income of each domestic corporation which is a member of a worldwide affiliated group shall be determined by allocating and apportioning interest expense of each member as if all members of such group were a single corporation.

“(B) Treatment of worldwide affiliated group.—The taxable income of the domestic members of a worldwide affiliated group from sources outside the United States shall be determined by allocating and apportioning the interest expense of such domestic members to
such income in an amount equal to the excess
(if any) of—

“(i) the total interest expense of the
worldwide affiliated group multiplied by
the ratio which the foreign assets of the
worldwide affiliated group bears to all the
assets of the worldwide affiliated group,
over

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

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

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

(2) CONFORMING AMENDMENTS.—

(A) Clauses (i) and (ii) of section 864(e)(4)(B) are each amended by striking “affiliated group” and inserting “worldwide affiliated group (as defined in paragraph (1)(C))”.

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

(b) TREATMENT OF FINANCIAL INSTITUTIONS.—

(1) TREATMENT AS SEPARATE WORLDWIDE GROUP.—

(A) IN GENERAL.—Paragraph (5) of section 864(e) is amended by striking so much of such paragraph as precedes subparagraph (C), by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively, and by inserting before subparagraph (B) (as so redesignated) the following:

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“(5) Treatment of Certain Financial Institutions.—

“(A) In General.—For purposes of paragraph (1), any corporation described in subparagraph (B) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying this subsection separately to corporations so described.”

(B) Conforming Amendment.—Subparagraph (C) of section 864(e)(5), as redesignated by subparagraph (A), is amended by striking “subparagraph (C)” and inserting “subparagraph (B)”.

(2) Election to Expand Financial Institution Group of Worldwide Group.—Subsection (e) of section 864 is amended by inserting after paragraph (5) the following new paragraph:

“(6) Election to Expand Financial Institution Group of Worldwide Group.—

“(A) In General.—If a worldwide affiliated group elects the application of this subsection, all financial corporations which—

“(i) are members of such worldwide affiliated group, but
“(ii) are not corporations described in paragraph (5)(B),

shall be treated as described in paragraph (5)(B) for purposes of applying paragraph (5)(A). This subsection (other than this paragraph) shall apply to any such group in the same manner as this subsection (other than this paragraph) applies to the pre-election worldwide affiliated group of which such group is a part.

“(B) FINANCIAL CORPORATION.—For purposes of this paragraph, the term ‘financial corporation’ means any corporation if at least 80 percent of its gross income is income described in section 904(d)(2)(C)(ii) and the regulations thereunder which is derived from transactions with persons who are not related (within the meaning of section 267(b) or 707(b)(1)) to the corporation. For purposes of the preceding sentence, there shall be disregarded any item of income or gain from a transaction or series of transactions a principal purpose of which is the qualification of any corporation as a financial corporation.

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

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

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

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

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

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

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

“(E) Definitions relating to
groups.—For purposes of this paragraph—
“(i) Pre-election Worldwide Affiliated Group.—The term ‘pre-election worldwide affiliated group’ means, with respect to a corporation, the worldwide affiliated group of which such corporation would (but for an election under this paragraph) be a member for purposes of applying paragraph (1).

“(ii) Electing Financial Institution Group.—The term ‘electing financial institution group’ means the group of corporations to which this subsection applies separately by reason of the application of paragraph (5)(A) and which includes financial corporations by reason of an election under subparagraph (A).

“(F) Regulations.—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection, including regulations—

“(i) providing for the direct allocation of interest expense in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,
“(ii) preventing assets or interest expense from being taken into account more than once, and

“(iii) dealing with changes in members of any group (through acquisitions or otherwise) treated under this paragraph as an affiliated group for purposes of this subsection.”.

(e) Expansion of Regulatory Authority.—

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

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

(2) by striking “and” at the end of subparagraph (E), by redesignating subparagraph (F) as subparagraph (G), and by inserting after subparagraph (E) the following new subparagraph:

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

(e) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.
SEC. 312. RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.

(a) GENERAL RULE.—Section 904 is amended by redesignating subsections (g), (h), (i), (j), and (k) as subsections (h), (i), (j), (k), and (l) respectively, and by inserting after subsection (f) the following new subsection:

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(g) RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.—

(1) GENERAL RULE.—For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall domestic loss for any taxable year beginning after December 31, 2002, that portion of the taxpayer's taxable income from sources within the United States for each succeeding taxable year which is equal to the lesser of—

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

(B) 50 percent of the taxpayer's taxable income from sources within the United States for such succeeding taxable year,

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

(2) OVERALL DOMESTIC LOSS DEFINED.—For purposes of this subsection—
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“(A) IN GENERAL.—The term ‘overall domestic loss’ means any domestic loss to the extent such loss offsets taxable income from sources without the United States for the taxable year or for any preceding taxable year by reason of a carryback. For purposes of the preceding sentence, the term ‘domestic loss’ means the amount by which the gross income for the taxable year from sources within the United States is exceeded by the sum of the deductions properly apportioned or allocated thereto (determined without regard to any carryback from a subsequent taxable year).

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

“(3) CHARACTERIZATION OF SUBSEQUENT INCOME.—

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

"
among and increase the income categories in proportion to the loss from sources within the United States previously allocated to those income categories.

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

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

(b) CONFORMING AMENDMENTS.—

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

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

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

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

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

“(1) IN GENERAL.—The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to income described in each of the following items of income:

“(A) passive income and other passive category income,

“(B) financial services income, and

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

(b) OTHER PASSIVE CATEGORY INCOME.—Subparagraph (A) of section 904(d)(2) is amended by adding at the end the following new clause:

“(v) OTHER PASSIVE CATEGORY INCOME.—The term ‘other passive category income’ means—

“(I) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States,
“(II) taxable income attributable to foreign trade income (within the meaning of section 923(b)), and “
“(III) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)).”

d (c) CONFORMING AMENDMENTS.—

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

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

“(III) high-taxed export financing interest.”

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

“(iv) HIGH-TAXED EXPORT FINANCING INTEREST.—The term ‘high-taxed ex-
port financing interest’ means any interest
if—

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

“(II) the rate of such tax appli-
cable to such interest is at least 5 per-
cent.

The Secretary may by regulations provide
that export financing interest (not other-
wise high-taxied export financing interest)
shall be treated as high-taxied export fi-
nancing interest where necessary to pre-
vent avoidance of the purposes of this sub-
paragraph, and a tax shall not be treated
as a withholding tax or other tax imposed
on a gross basis if such tax is in the na-
ture of a prepayment of a tax imposed on
a net basis.”

(3) Clause (iii) of section 904(d)(2)(C) is
amended to read as follows:

“(iii) EXCEPTIONS.—The term ‘finan-
cial services income’ does not include—
“(I) in the case of a corporation, dividends from noncontrolled section 902 corporations out of earnings and profits accumulated in taxable years beginning before January 1, 2003, and
“(II) any export financing interest which is not high-taxed export financing interest.”

(4) Subparagraph (E) of section 904(d)(2) is amended by striking clause (ii) and by redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively.

(5) Clause (i) of section 904(d)(3)(F) is amended to read as follows:
“(i) IN GENERAL.—Except as provided in clause (ii), the separate categories are—
“(I) passive income and other passive category income, and
“(II) financial services income.”

(6) Paragraph (3) of section 904(d) is amended by striking subparagraph (H) and by redesignating subparagraph (I) as subparagraph (H).
(7) Paragraph (2) of section 904(d) is amended by adding at the end the following new subpara-
graph:

“(I) Transitional rule for 2002 changes.—For purposes of paragraph (1), taxes carried from any taxable year beginning before January 1, 2003, to any taxable year begin-
ing on or after such date, with respect to any item of income shall be treated as described in the subparagraph of paragraph (1) in which such income would be described were such taxes paid or accrued in a taxable year beginning on or after such date.”

(d) Effective date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 314. 10-Year Foreign Tax Credit Carryforward.

(a) General Rule.—Section 904(c) (relating to carryback and carryover of excess tax paid) is amended by striking “in the first, second, third, fourth, or fifth” and inserting “in any of the first 10”.

(b) Excess Extraction Taxes.—Paragraph (1) of section 907(f) is amended by striking “in the first, second, third, fourth, or fifth” and inserting “in any of the first 10”.

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(c) Effective Date.—The amendments made by this section shall apply to excess foreign taxes which (without regard to the amendments made by this section) may be carried to any taxable year beginning after December 31, 2002.

SEC. 315. REPEAL OF LIMITATION OF FOREIGN TAX CREDIT UNDER ALTERNATIVE MINIMUM TAX.

(a) In General.—Section 59(a) (relating to alternative minimum tax foreign tax credit) is amended by striking paragraph (2) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

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

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 316. LOOK-THRU RULES TO APPLY TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.

(a) In General.—Section 904(d)(4) (relating to look-thru rules apply to dividends from noncontrolled section 902 corporations) is amended to read as follows:

“(4) Look-thru applies to dividends from noncontrolled section 902 corporations.—
“(A) IN GENERAL.—For purposes of this subsection, any dividend from a noncontrolled section 902 corporation with respect to the taxpayer shall be treated as income in a separate category in proportion to the ratio of—

“(i) the portion of earnings and profits attributable to income in such category, to

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

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

“(i) IN GENERAL.—Rules similar to the rules of paragraph (3)(F) shall apply.

“(ii) EARNINGS AND PROFITS.—

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

“(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer’s acquisition of the stock to which the distributions relate.
“(iii) DIVIDENDS NOT ALLOCABLE TO SEPARATE CATEGORY.—The portion of any dividend from a noncontrolled section 902 corporation which is not treated as income in a separate category under subparagraph (A) shall be treated as a dividend to which subparagraph (A) does not apply.

“(iv) LOOK-THRU WITH RESPECT TO CARRYFORWARDS OF CREDIT.—Rules similar to subparagraph (A) also shall apply to any carryforward under subsection (c) from a taxable year beginning before January 1, 2003, of tax allocable to a dividend from a noncontrolled section 902 corporation with respect to the taxpayer.”.

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (E) of section 904(d)(1), as in effect both before and after the amendments made by section 1105 of the Taxpayer Relief Act of 1997, is hereby repealed.

(2) Section 904(d)(2)(C)(iii), as so in effect, is amended by striking subclause (II) and by redesignating subclause (III) as subclause (II).
(3) The last sentence of section 904(d)(2)(D), as so in effect, is amended to read as follows: “Such term does not include any financial services income.”

(4) Section 904(d)(2)(E) is amended by striking clauses (ii) and (iv) and by redesignating clause (iii) as clause (ii).

(5) Section 904(d)(3)(F) is amended by striking “(D), or (E)” and inserting “or (D)”.

(6) Section 864(d)(5)(A)(i) is amended by striking “(C)(iii)(III)” and inserting “(C)(iii)(II)”.

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

SEC. 317. ATTRIBUTION OF STOCK OWNERSHIP THROUGH PARTNERSHIPS TO APPLY IN DETERMINING SECTION 902 AND 960 CREDITS.

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

“(7) CONSTRUCTIVE OWNERSHIP THROUGH PARTNERSHIPS.—Stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by its partners. Stock considered to be owned by a person by reason of the pre-
ceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person. The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including rules to account for special partnership allocations of dividends, credits, and other incidents of ownership of stock in determining proportionate ownership.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxes of foreign corporations for taxable years of such corporations beginning after December 31, 2002.

Subtitle C—Other Provisions

SEC. 321. APPLICATION OF UNIFORM CAPITALIZATION RULES TO FOREIGN PERSONS.

(a) IN GENERAL.—Section 263A(e) (relating to exceptions) is amended by adding at the end the following new paragraph:

“(7) FOREIGN PERSONS.—Except for purposes of applying sections 871(b)(1) and 882(a)(1), this section shall not apply to any taxpayer who is not a United States person if such taxpayer capitalizes costs of produced property or property acquired for resale by applying the method used to ascertain the income, profit, or loss for purposes of reports or
statements to shareholders, partners, other propri-
etors, or beneficiaries, or for credit purposes.”

(b) Effective Date.—The amendment made by
subsection (a) shall apply to taxable years beginning after
December 31, 2002. Section 481 of the Internal Revenue
Code of 1986 shall not apply to any change in a method
of accounting by reason of such amendment.

SEC. 322. UNITED STATES PROPERTY NOT TO INCLUDE
CERTAIN ASSETS ACQUIRED BY DEALERS IN
ORDINARY COURSE OF TRADE OR BUSINESS.

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

“(L) securities acquired and held by a con-
trolled foreign corporation in the ordinary
course of its business as a dealer in securities
if (i) the dealer accounts for the securities as
securities held primarily for sale to customers
in the ordinary course of business, and (ii) the
dealer disposes of the securities (or such securi-
ties mature while held by the dealer) within a
period consistent with the holding of securities
for sale to customers in the ordinary course of business.”

(b) Conforming Amendment.—Section 956(c)(2) is amended by striking “and (K)” in the last sentence and inserting “, (K), and (L)”.

(c) Effective Date.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2002, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

**SEC. 323. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.**

(a) Treatment of Certain Dividends.—

(1) Nonresident Alien Individuals.—Section 871 (relating to tax on nonresident alien individuals) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

“(k) Exemption for Certain Dividends of Regulated Investment Companies.—

“(1) Interest-related dividends.—

“(A) In general.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on
any interest-related dividend received from a regulated investment company.

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

“(i) to any interest-related dividend received from a regulated investment company by a person to the extent such dividend is attributable to interest (other than interest described in subparagraph (E) (i) or (iii)) received by such company on indebtedness issued by such person or by any corporation or partnership with respect to which such person is a 10-percent shareholder,

“(ii) to any interest-related dividend with respect to stock of a regulated investment company unless the person who would otherwise be required to deduct and withhold tax from such dividend under chapter 3 receives a statement (which meets requirements similar to the requirements of subsection (h)(5)) that the beneficial owner of such stock is not a United States person, and
“(iii) to any interest-related dividend paid to any person within a foreign country (or any interest-related dividend payment addressed to, or for the account of, persons within such foreign country) during any period described in subsection (h)(6) with respect to such country.

Clause (iii) shall not apply to any dividend with respect to any stock which was acquired on or before the date of the publication of the Secretary’s determination under subsection (h)(6).

“(C) INTEREST-RELATED DIVIDEND.—For purposes of this paragraph, an interest-related dividend is any dividend (or part thereof) which is designated by the regulated investment company as an interest-related dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year.

If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified net interest income of the company for such taxable year, the portion of each distribu-
tion which shall be an interest-related dividend
shall be only that portion of the amounts so
designated which such qualified net interest in-
come bears to the aggregate amount so des-
ignated.

“(D) QUALIFIED NET INTEREST IN-
COME.—For purposes of subparagraph (C), the
term ‘qualified net interest income’ means the
qualified interest income of the regulated in-
vestment company reduced by the deductions
properly allocable to such income.

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

“(i) Any amount includible in gross
income as original issue discount (within
the meaning of section 1273) on an obliga-
tion payable 183 days or less from the date
of original issue (without regard to the pe-
riod held by the company).

“(ii) Any interest includible in gross
income (including amounts recognized as
ordinary income in respect of original issue
discount or market discount or acquisition
discount under part V of subchapter P and
such other amounts as regulations may
provide) on an obligation which is in reg-
istered form; except that this clause shall
not apply to—

“(I) any interest on an obligation
issued by a corporation or partnership
if the regulated investment company
is a 10-percent shareholder in such
corporation or partnership, and

“(II) any interest which is treat-
ed as not being portfolio interest
under the rules of subsection (h)(4).

“(iii) Any interest referred to in sub-
section (i)(2)(A) (without regard to the
trade or business of the regulated invest-
ment company).

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

“(F) 10-PERCENT SHAREHOLDER.—For
purposes of this paragraph, the term ‘10-per-
cent shareholder’ has the meaning given such term by subsection (h)(3)(B).

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

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

“(B) EXCEPTION FOR ALIENS TAXABLE UNDER SUBSECTION (a)(2).—In the case of dividends received from a regulated investment company before January 1, 2003, subparagraph (A) shall not apply in the case of any non-resident alien individual subject to tax under subsection (a)(2).

“(C) SHORT-TERM CAPITAL GAIN DIVIDEND.—For purposes of this paragraph, a short-term capital gain dividend is any dividend (or part thereof) which is designated by the regulated investment company as a short-term capital gain dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so des-
Ignated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified short-term gain of the company for such taxable year, the portion of each distribution which shall be a short-term capital gain dividend shall be only that portion of the amounts so designated which such qualified short-term gain bears to the aggregate amount so designated.

“(D) QUALIFIED SHORT-TERM GAIN.—For purposes of subparagraph (C), the term ‘qualified short-term gain’ means the excess of the net short-term capital gain of the regulated investment company for the taxable year over the net long-term capital loss (if any) of such company for such taxable year. For purposes of this subparagraph—

“(i) the net short-term capital gain of the regulated investment company shall be computed by treating any short-term capital gain dividend includible in gross income with respect to stock of another regulated investment company as a short-term capital gain, and
“(ii) the excess of the net short-term capital gain for a taxable year over the net long-term capital loss for a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of such year, and any such net capital loss or net short-term capital loss shall be treated as arising on the 1st day of the next taxable year.

To the extent provided in regulations, clause (ii) shall apply also for purposes of computing the taxable income of the regulated investment company.”

(2) FOREIGN CORPORATIONS.—Section 881 (relating to tax on income of foreign corporations not connected with United States business) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

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

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

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

“(i) to any dividend referred to in section 871(k)(1)(B), and

“(ii) to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company from a person who is a related person (within the meaning of section 864(d)(4)) with respect to such controlled foreign corporation.

“(C) TREATMENT OF DIVIDENDS RECEIVED BY CONTROLLED FOREIGN CORPORATIONS.—The rules of subsection (c)(5)(A) shall apply to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such
dividend is attributable to interest received by
the regulated investment company which is de-
scribed in clause (ii) of section 871(k)(1)(E)
(and not described in clause (i) or (iii) of such
section).

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

(3) WITHHOLDING TAXES.—

(A) Section 1441(c) (relating to excep-
tions) is amended by adding at the end the fol-
lowing new paragraph:

“(12) CERTAIN DIVIDENDS RECEIVED FROM
REGULATED INVESTMENT COMPANIES.—

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

“(B) SPECIAL RULE.—For purposes of
subparagraph (A), clause (i) of section
871(k)(1)(B) shall not apply to any dividend
unless the regulated investment company knows
that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B)."

(B) Section 1442(a) (relating to withholding of tax on foreign corporations) is amended—

(i) by striking "and the reference in section 1441(c)(10)" and inserting "the reference in section 1441(c)(10)", and

(ii) by inserting before the period at the end the following: "and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause)".

(b) Estate Tax Treatment of Interest in Certain Regulated Investment Companies.—Section 2105 (relating to property without the United States for
estate tax purposes) is amended by adding at the end the following new subsection:

“(d) STOCK IN A RIC.—

“(1) IN GENERAL.—For purposes of this subchapter, stock in a regulated investment company (as defined in section 851) owned by a nonresident not a citizen of the United States shall not be deemed property within the United States in the proportion that, at the end of the quarter of such investment company’s taxable year immediately preceding a decedent’s date of death (or at such other time as the Secretary may designate in regulations), the assets of the investment company that were qualifying assets with respect to the decedent bore to the total assets of the investment company.

“(2) QUALIFYING ASSETS.—For purposes of this subsection, qualifying assets with respect to a decedent are assets that, if owned directly by the decedent, would have been—

“(A) amounts, deposits, or debt obligations described in subsection (b) of this section,

“(B) debt obligations described in the last sentence of section 2104(e), or

“(C) other property not within the United States.”
(c) Treatment of Regulated Investment Companies Under Section 897.—

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

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

“(2) Sale of stock in domestically controlled entity not taxed.—The term ‘United States real property interest’ does not include any interest in a domestically controlled qualified investment entity.

“(3) Distributions by domestically controlled qualified investment entities.—In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.”

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

“(A) Qualified investment entity.—The term ‘qualified investment entity’ means any real estate investment trust and any regulated investment company.
“(B) DOMESTICALLY CONTROLLED.—The term ‘domestically controlled qualified investment entity’ means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.”

(4) Subparagraphs (C) and (D) of section 897(h)(4) are each amended by striking “REIT” and inserting “qualified investment entity”.

(5) The subsection heading for subsection (h) of section 897 is amended by striking “REITS” and inserting “CERTAIN INVESTMENT ENTITIES”.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to dividends with respect to taxable years of regulated investment companies beginning after the date of the enactment of this Act.

(2) ESTATE TAX TREATMENT.—The amendment made by subsection (b) shall apply to estates of decedents dying after the date of the enactment of this Act.

(3) CERTAIN OTHER PROVISIONS.—The amendments made by subsection (c) (other than paragraph
(1) thereof) shall take effect on the date of the enacment of this Act.

SEC. 324. ELECTION NOT TO USE AVERAGE EXCHANGE RATE FOR FOREIGN TAX PAID OTHER THAN IN FUNCTIONAL CURRENCY.

(a) IN GENERAL.—Paragraph (1) of section 986(a) (relating to determination of foreign taxes and foreign corporation’s earnings and profits) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

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

“(i) IN GENERAL.—At the election of the taxpayer, subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any currency other than in the taxpayer’s functional currency.

“(ii) APPLICATION TO QUALIFIED BUSINESS UNITS.—An election under this subparagraph may apply to foreign income taxes attributable to a qualified business
unit in accordance with regulations prescribed by the Secretary.

“(iii) Election.—Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.”

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 325. REPEAL OF WITHHOLDING TAX ON DIVIDENDS FROM CERTAIN FOREIGN CORPORATIONS.

(a) In General.—Paragraph (2) of section 871(i) (relating to tax not to apply to certain interest and dividends) is amended by adding at the end the following new subparagraph:

“(D) Dividends paid by a foreign corporation.”.

(b) Effective Date.—The amendment made by this section shall apply to payments made after December 31, 2002.

SEC. 326. INCREASE IN EXPENSING UNDER SECTION 179.

(a) Increase in Dollar Limitations.—
(1) IN GENERAL.—Paragraph (1) of section 179(b) (relating to dollar limitation) is amended to read as follows:

“(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $25,000 ($40,000 in the case of taxable years beginning after December 31, 2012).”

(2) INCREASE IN PHASEOUT THRESHOLD.—

Paragraph (2) of section 179(b) is amended by inserting before the period “($325,000 in the case of taxable years beginning after December 31, 2012).”.

(b) INFLATION ADJUSTMENTS.—

(1) IN GENERAL.—Subsection (b) of section 179 is amended by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively, and by inserting after paragraph (2) the following new paragraph:

“(3) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2004, the dollar amounts contained in paragraphs (1) and (2) which would (but for this paragraph) apply to such taxable year shall be increased by an amount equal to the product of—

“(A) such dollar amount, and
“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting in subparagraph (B) thereof—

“(i) ‘calendar year 2003’ for ‘calendar year 1992’ with respect to the $25,000 and $200,000 amounts, and

“(ii) ‘calendar year 2011’ for ‘calendar year 1992’ with respect to the $40,000 and $325,000 amounts.

If any amount after adjustment under the preceding sentence is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.”

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 179(b)(5), as redesignated by paragraph (1), is amended by striking “paragraph (3)” and inserting “paragraph (4)”.

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

SEC. 327. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL INCOME.

(a) In General.—Section 114 is hereby repealed.
(b) CONFORMING AMENDMENTS.—

(1) Subpart E of part III of subchapter N of chapter 1 (relating to qualifying foreign trade income) is hereby repealed.

(2) The table of subparts for such part III is amended by striking the item relating to subpart E.

(3) The table of sections for part III of subchapter B of chapter 1 is amended by striking the item relating to section 114.

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

SEC. 328. REPEAL OF FSC TRANSITIONAL RULES.

(a) IN GENERAL.—Subsections (c) and (d) of section 5 of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 are hereby repealed.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the calendar year which includes the date of the enactment of this Act.
TITLE IV—OTHER PROVISIONS

SEC. 401. EXTENSION OF INTERNAL REVENUE SERVICE USER FEES.

(a) In general.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end the following new section:

“SEC. 7527. INTERNAL REVENUE SERVICE USER FEES.

“(a) General rule.—The Secretary shall establish a program requiring the payment of user fees for—

“(1) requests to the Internal Revenue Service for ruling letters, opinion letters, and determination letters, and

“(2) other similar requests.

“(b) Program criteria.—

“(1) In general.—The fees charged under the program required by subsection (a)—

“(A) shall vary according to categories (or subcategories) established by the Secretary,

“(B) shall be determined after taking into account the average time for (and difficulty of) complying with requests in each category (and subcategory), and

“(C) shall be payable in advance.

“(2) Exemptions, etc.—
“(A) In general.—The Secretary shall provide for such exemptions (and reduced fees) under such program as the Secretary determines to be appropriate.

“(B) Exemption for certain requests regarding pension plans.—The Secretary shall not require payment of user fees under such program for requests for determination letters with respect to the qualified status of a pension benefit plan maintained solely by 1 or more eligible employers or any trust which is part of the plan. The preceding sentence shall not apply to any request—

“(i) made after the later of—

“(I) the fifth plan year the pension benefit plan is in existence, or

“(II) the end of any remedial amendment period with respect to the plan beginning within the first 5 plan years, or

“(ii) made by the sponsor of any prototype or similar plan which the sponsor intends to market to participating employers.
“(C) DEFINITIONS AND SPECIAL RULES.—

For purposes of subparagraph (B)—

“(i) PENSION BENEFIT PLAN.—The term ‘pension benefit plan’ means a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan.

“(ii) ELIGIBLE EMPLOYER.—The term ‘eligible employer’ means an eligible employer (as defined in section 408(p)(2)(C)(i)(I)) which has at least 1 employee who is not a highly compensated employee (as defined in section 414(q)) and is participating in the plan. The determination of whether an employer is an eligible employer under subparagraph (B) shall be made as of the date of the request described in such subparagraph.

“(iii) DETERMINATION OF AVERAGE FEES CHARGED.—For purposes of any determination of average fees charged, any request to which subparagraph (B) applies shall not be taken into account.

“(3) AVERAGE FEE REQUIREMENT.—The average fee charged under the program required by sub-
section (a) shall not be less than the amount determined under the following table:

<table>
<thead>
<tr>
<th>Category</th>
<th>Average Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee plan ruling and opinion</td>
<td>$250</td>
</tr>
<tr>
<td>Exempt organization ruling</td>
<td>$350</td>
</tr>
<tr>
<td>Employee plan determination</td>
<td>$300</td>
</tr>
<tr>
<td>Exempt organization determination</td>
<td>$275</td>
</tr>
<tr>
<td>Chief counsel ruling</td>
<td>$200.</td>
</tr>
</tbody>
</table>

“(c) TERMINATION.—No fee shall be imposed under this section with respect to requests made after December 31, 2012.”

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for chapter 77 is amended by adding at the end the following new item:

“Sec. 7527. Internal Revenue Service user fees.”.

(2) Section 10511 of the Revenue Act of 1987 is repealed.

(3) Section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 is repealed.

(c) LIMITATIONS.—Notwithstanding any other provision of law, any fees collected pursuant to section 7527 of the Internal Revenue Code of 1986, as added by subsection (a), shall not be expended by the Internal Revenue Service unless provided by an appropriations Act.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to requests made after the date of the enactment of this Act.
SEC. 402. EXTENSION OF CUSTOMS USER FEES.


(b) CUSTOMS AUTOMATION FUND.—Section 13031(f) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(f)) is amended—

(1) in paragraph (1), by striking subparagraph (B) and inserting the following:

“(B) amounts deposited into the Customs Commercial Automation Account under paragraph (5).”;

(2) in paragraph (4), by striking “(other than the excess fees determined by the Secretary under paragraph (5))”; and

(3) by striking paragraph (5) and inserting the following:

“(5)(A) There is created within the general fund of the Treasury a separate account that shall be known as the ‘Customs Commercial Automation Account’. In each of fiscal years 2003, 2004, and 2005 there shall be deposited into the Customs Commercial Automation Account from fees collected under subsection (a)(9)(A), $350,000,000.

“(B) There is authorized to be appropriated from the Customs Commercial Automation Account in fiscal years

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2003 through 2005 such amounts as are available in that
Account for the development, establishment, and imple-
mentation of the Automated Commercial Environment
computer system for the processing of merchandise that
is entered or released. Amounts appropriated pursuant to
this subparagraph are authorized to remain available until
expended.

“(C) In adjusting the fee imposed by subsection
(a)(9)(A) for fiscal year 2006, the Secretary of the Treas-
ury shall reduce the amount estimated to be collected in
fiscal year 2006 by the amount by which total fees depos-
ited to the Customs Commercial Automation Account dur-
ing fiscal years 2003, 2004, and 2005 exceed total appro-
priations from that Account.”.

SEC. 403. INCLUSION IN GROSS INCOME OF FUNDED DE-
FERRED COMPENSATION OF CORPORATE IN-
SIDERS.

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

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

“(a) IN GENERAL.—If an employer maintains a fund-
ed deferred compensation plan—
“(1) compensation of any disqualified individual which is deferred under such funded deferred compensation plan shall be included in the gross income of the disqualified individual or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

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

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

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

“(A) the employee’s rights to the compensation deferred under the plan are no greater than the rights of a general creditor of the employer, and

“(B) all amounts set aside (directly or indirectly) for purposes of paying the deferred compensation, and all income attributable to such amounts, remain (until made available to the participant or other beneficiary) solely the property of the employer (without being re-
restricted to the provision of benefits under the plan), and

“(C) the amounts referred to in subparagraph (B) are available to satisfy the claims of the employer’s general creditors at all times (not merely after bankruptcy or insolvency).

Such term shall not include a qualified employer plan.

“(2) SPECIAL RULES.—

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

“(i) the compensation deferred under the plan is payable only upon separation from service, death, or at a specified time (or pursuant to a fixed schedule), and

“(ii) the plan does not permit the acceleration of the time such deferred compensation is payable by reason of any event.

If the employer and employee agree to a modification of the plan that accelerates the time for payment of any deferred compensation, then all compensation previously deferred under the plan shall be includible in gross income for the
taxable year during which such modification

takes effect and the taxpayer shall pay interest

at the underpayment rate on the underpay-
ments that would have occurred had the de-
ferred compensation been includible in gross in-
come on the earliest date that there is no sub-
stantial risk of forfeiture of the rights to such
compensation.

“(B) CREDITOR’S RIGHTS.—A plan shall

be treated as failing to meet the requirements

of paragraph (1)(B) with respect to amounts

set aside in a trust unless—

“(i) the employee has no beneficial in-

terest in the trust,

“(ii) assets in the trust are available
to satisfy claims of general creditors at all
times (not merely after bankruptcy or in-

solvenecy), and

“(iii) there is no factor that would

make it more difficult for general creditors
to reach the assets in the trust than it
would be if the trust assets were held di-
rectly by the employer in the United

States.
Except as provided in regulations prescribed by the Secretary, such a factor shall include the location of the trust outside the United States.

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

“(1) who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to such corporation, or

“(2) who would be subject to such requirements if such corporation were an issuer of equity securities referred to in such section.

“(d) OTHER DEFINITIONS AND SPECIAL RULES.—

For purposes of this section—

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

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

“(B) any other plan of an organization exempt from tax under subtitle A.

“(2) PLAN INCLUDES ARRANGEMENTS, ETC.—

The term ‘plan’ includes any agreement or arrangement.
“(3) Substantial risk of forfeiture.—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person’s rights to such compensation are conditioned upon the future performance of substantial services by any individual.

“(4) Treatment of earnings.—Except for purposes of subsection (a)(1) and the last sentence of (b)(2)(A), references to deferred compensation shall be treated as including references to income attributable to such compensation or such income.”

(b) Clerical Amendment.—The table of sections for such subpart A is amended by adding at the end the following new item:

“Sec. 409A. Inclusion in gross income of funded deferred compensation of corporate insiders.”

(b) Effective Date.—The amendments made by this section shall apply to amounts deferred after July 10, 2002.

SEC. 404. SIMPLIFICATION OF EXCISE TAX IMPOSED ON BOWS AND ARROWS.

(a) Bows.—Section 4161(b)(1) (relating to bows) is amended to read as follows:

“(1) Bows.—

“(A) In general.—There is hereby imposed on the sale by the manufacturer, pro-
ducer, or importer of any bow which has a draw
weight of 30 pounds or more, a tax equal to 11
percent of the price for which so sold.

“(B) Archery Equipment.—There is
hereby imposed on the sale by the manufac-
turer, producer, or importer—

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

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

(b) Arrows.—Section 4161(b) (relating to bows and
arrows, etc.) is amended by redesignating paragraph (3)
as paragraph (4) and inserting after paragraph (2) the
following:

“(3) Arrows.—

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

“(B) Exception.—The tax imposed by
subparagraph (A) on an arrow shall not apply
if the arrow contains an arrow shaft subject to
the tax imposed by paragraph (2).

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

(e) Conforming Amendment.—The heading of sec-
tion 4161(b)(2) (relating to arrows) is amended by strik-
ing “Arrows.—” and inserting “Arrow Compo-
ents.—”.

(d) Effective Date.—The amendments made by
this section shall apply to articles sold by the manufac-
turer, producer, or importer after December 31, 2001.

SEC. 405. EXCLUSION FROM GROSS INCOME FOR INTEREST
ON OVERPAYMENTS OF INCOME TAX BY INDIVIDUALS.

(a) In General.—Part III of subchapter B of chap-
ter 1 (relating to items specifically excluded from gross
income) is amended by inserting after section 139 the fol-
lowing new section:
“SEC. 139A. EXCLUSION FROM GROSS INCOME FOR INTER-
EST ON OVERPAYMENTS OF INCOME TAX BY
INDIVIDUALS.
“(a) IN GENERAL.—In the case of an individual, gross income shall not include interest paid under section 6611 on any overpayment of tax imposed by this subtitle.
“(b) EXCEPTION.—Subsection (a) shall not apply in the case of a failure to claim items resulting in the over-
payment on the original return if the Secretary determines that the principal purpose of such failure is to take advan-
tage of subsection (a).
“(c) SPECIAL RULE FOR DETERMINING MODIFIED ADJUSTED GROSS INCOME.—For purposes of this title, interest not included in gross income under subsection (a) shall not be treated as interest which is exempt from tax for purposes of sections 32(i)(2)(B) and 6012(d) or any computation in which interest exempt from tax under this title is added to adjusted gross income.”.
(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 139 the fol-
lowing new item:

“Sec. 139A. Exclusion from gross income for interest on over-
payments of income tax by individuals.”.
(c) Effective Date.—The amendments made by this section shall apply to interest received in calendar years beginning after December 31, 2006.

SEC. 406. DEPOSITS MADE TO SUSPEND RUNNING OF INTEREST ON POTENTIAL UNDERPAYMENTS.

(a) In General.—Subchapter A of chapter 67 (relating to interest on underpayments) is amended by adding at the end the following new section:

“SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF INTEREST ON POTENTIAL UNDERPAYMENTS, ETC.

“(a) Authority To Make Deposits Other Than As Payment of Tax.—A taxpayer may make a cash deposit with the Secretary which may be used by the Secretary to pay any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been assessed at the time of the deposit. Such a deposit shall be made in such manner as the Secretary shall prescribe.

“(b) No Interest Imposed.—To the extent that such deposit is used by the Secretary to pay tax, for purposes of section 6601 (relating to interest on underpayments), the tax shall be treated as paid when the deposit is made.

“(c) Return of Deposit.—Except in a case where the Secretary determines that collection of tax is in jeop-
ardy, the Secretary shall return to the taxpayer any amount of the deposit (to the extent not used for a payment of tax) which the taxpayer requests in writing.

“(d) Payment of Interest.—

“(1) In General.—For purposes of section 6611 (relating to interest on overpayments), a deposit which is returned to a taxpayer shall be treated as a payment of tax for any period to the extent (and only to the extent) attributable to a disputable tax for such period. Under regulations prescribed by the Secretary, rules similar to the rules of section 6611(b)(2) shall apply.

“(2) Disputable Tax.—

“(A) In General.—For purposes of this section, the term ‘disputable tax’ means the amount of tax specified at the time of the deposit as the taxpayer’s reasonable estimate of the maximum amount of any tax attributable to disputable items.

“(B) Safe Harbor Based on 30-Day Letter.—In the case of a taxpayer who has been issued a 30-day letter, the maximum amount of tax under subparagraph (A) shall not be less than the amount of the proposed deficiency specified in such letter.
“(3) Other definitions.—For purposes of paragraph (2)—

“(A) Disputable item.—The term ‘disputable item’ means any item of income, gain, loss, deduction, or credit if the taxpayer—

“(i) has a reasonable basis for its treatment of such item, and

“(ii) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer’s treatment of such item.

“(B) 30-day letter.—The term ‘30-day letter’ means the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

“(4) Rate of interest.—The rate of interest allowable under this subsection shall be the Federal short-term rate determined under section 6621(b), compounded daily.

“(e) Use of deposits.—

“(1) Payment of tax.—Except as otherwise provided by the taxpayer, deposits shall be treated as used for the payment of tax in the order deposited.
“(B) RETURNS OF DEPOSITS.—Deposits shall
be treated as returned to the taxpayer on a last-in,
first-out basis.”.

(b) CLERICAL AMENDMENT.—The table of sections
for subchapter A of chapter 67 is amended by adding at
the end the following new item:

“Sec. 6603. Deposits made to suspend running of interest on po-
tential underpayments, etc.”.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by
this section shall apply to deposits made after the
date of the enactment of this Act.

(2) COORDINATION WITH DEPOSITS MADE
UNDER REVENUE PROCEDURE 84–58.—In the case of
an amount held by the Secretary of the Treasury or
his delegate on the date of the enactment of this Act
as a deposit in the nature of a cash bond deposit
pursuant to Revenue Procedure 84–58, the date that
the taxpayer identifies such amount as a deposit
made pursuant to section 6603 of the Internal Rev-

due Code (as added by this Act) shall be treated as
the date such amount is deposited for purposes of
such section 6603.

SEC. 407. PARTIAL PAYMENT OF TAX LIABILITY IN IN-
STALLMENT AGREEMENTS.

(a) IN GENERAL.—
(1) Section 6159(a) (relating to authorization of agreements) is amended—

(A) by striking “satisfy liability for payment of” and inserting “make payment on”, and

(B) by inserting “full or partial” after “facilitate”.

(2) Section 6159(c) (relating to Secretary required to enter into installment agreements in certain cases) is amended in the matter preceding paragraph (1) by inserting “full” before “payment”.

(b) REQUIREMENT TO REVIEW PARTIAL PAYMENT AGREEMENTS EVERY TWO YEARS.—Section 6159 is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and inserting after subsection (c) the following new subsection:

“(d) SECRETARY REQUIRED TO REVIEW INSTALLMENT AGREEMENTS FOR PARTIAL COLLECTION EVERY TWO YEARS.—In the case of an agreement entered into by the Secretary under subsection (a) for partial collection of a tax liability, the Secretary shall review the agreement at least once every 2 years.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to agreements entered into on or after the date of the enactment of this Act.
SEC. 408. EXTENSION OF TRANSFERS OF EXCESS PENSION ASSETS TO RETIREE HEALTH ACCOUNTS.

Paragraph (5) of section 420(b) (relating to expiration) is amended by striking “December 31, 2005” and inserting “December 31, 2012”.

SEC. 409. CLARIFICATION OF RULES FOR PAYMENT OF ESTIMATED TAX FOR CERTAIN DEEMED ASSET SALES.

(a) In General.—Paragraph (13) of section 338(h) (relating to tax on deemed sale not taken into account for estimated tax purposes) is amended by adding at the end the following: “The preceding sentence shall not apply with respect to a qualified stock purchase for which an election is made under paragraph (10).”.

(b) Effective Date.—The amendment made by subsection (a) shall apply to transactions occurring after the date of the enactment of this Act.