

PROVIDING FOR CONSIDERATION OF H.R. 4227, MIDDLE-
CLASS ALTERNATIVE MINIMUM TAX RELIEF ACT OF 2004

MAY 4, 2004.—Referred to the House Calendar and ordered to be printed

Mr. LINDER, from the Committee on Rules,
submitted the following

R E P O R T

[To accompany H. Res. 619]

The Committee on Rules, having had under consideration House Resolution 619, by a record vote of 7 to 4, report the same to the House with the recommendation that the resolution be adopted.

SUMMARY OF PROVISIONS OF THE RESOLUTION

The resolution provides for the consideration of H.R. 4227, the Middle-Class Alternative Minimum Tax Relief Act of 2004, under a modified closed rule. The rule provides one hour of debate in the House equally divided and controlled by the chairman and ranking minority member of the Committee on Ways and Means.

The rule provides for consideration of the amendment in the nature of a substitute printed in this report, if offered by Representative Rangel of New York or his designee, which shall be considered as read, and shall be separately debatable for one hour equally divided and controlled by the proponent and an opponent. The rule waives all points of order against the amendment printed in this report.

Finally, the rule provides one motion to recommit with or without instructions.

COMMITTEE VOTES

Pursuant to clause 3(b) of House rule XIII the results of each record vote on an amendment or motion to report, together with the names of those voting for and against, are printed below:

Rules Committee record vote No. 249

Date: May 4, 2004.

Measure: H.R. 4227, Middle-Class Alternative Minimum Tax Relief Act of 2004.

Motion by: Mr. Frost.

Summary of motion: To make in order and provide the appropriate waivers for the amendment offered by Representative Baird which adds a new section at the end of the bill that would allow taxpayers to deduct either their state and local income tax or their state and local sales tax for 2004 only. Gives a choice of deducting either sales or income tax. Budgetary score keeping is kept to a minimum. Directs the IRS to develop standard tables for taxpayers to use in determining their average sales tax deduction. Such tables, similar to those used by taxpayers prior to 1986, would include average calculations, based upon income and household size, for a taxpayer in a given state. The amendment does not restore the itemized deduction of individual purchases; it only allows taxpayers to deduct an averaged amount based on income level and family size.

Results: Defeated 5 to 6.

Vote by Members: Goss—Nay; Linder—Nay; Diaz-Balart—Nay; Hastings (WA)—Nay; Myrick—Nay; Sessions—Yea; Frost—Yea; Slaughter—Yea; McGovern—Yea; Hastings (FL)—Yea; Dreier—Nay.

Rules Committee record vote No. 250

Date: May 4, 2004.

Measure: H.R. 4227, Middle-Class Alternative Minimum Tax Relief Act of 2004.

Motion by: Mr. Goss.

Summary of motion: To report the resolution.

Results: Agreed to 7 to 4.

Vote by Members: Goss—Yea; Linder—Yea; Diaz-Balart—Yea; Hastings (WA)—Yea; Myrick—Yea; Sessions—Yea; Frost—Nay; Slaughter—Nay; McGovern—Nay; Hastings (FL)—Nay; Dreier—Yea.

SUMMARY OF AMENDMENT MADE IN ORDER

(Summary derived from information provided by the amendment sponsor.)

Rangel: Amendment in the Nature of a Substitute. Eliminates all liability for the individual minimum tax for taxpayers whose adjusted gross incomes are less than \$250,000 (\$125,000 for single taxpayers). Above those income levels, AMT liabilities would be phased in over a \$40,000 range (\$20,000 for single taxpayers). Requires the Treasury Department to submit recommendations to reform the minimum tax so that the number of individuals subject to the minimum tax would be less than one percent, the percentage that was in effect before the 2001 tax cut. The Ways and Means Committee would be required to act on those recommendations. The cost of the amendment would be offset by restrictions on tax shelter transactions that have been approved by the Senate Finance Committee.

TEXT OF AMENDMENT MADE IN ORDER

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE; TABLE OF CONTENTS.

(a) **SHORT TITLE.**—This Act may be cited as the “AMT Reform Act of 2004”.

(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 to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) **TABLE OF CONTENTS.**—

Sec. 1. Short title; amendment of 1986 Code; table of contents.
Sec. 2. Statement of Congressional findings and purposes.

TITLE I—TEMPORARY RELIEF FROM THE ALTERNATIVE MINIMUM TAX; FRAMEWORK FOR REFORM

Sec. 101. Temporary relief from the alternative minimum tax.
Sec. 102. Framework for reform.

TITLE II—RESTRICTIONS ON TAX SHELTERS

Subtitle A—Provisions Designed To Curtail Tax Shelters

Sec. 201. Clarification of economic substance doctrine.
Sec. 202. Penalty for failing to disclose reportable transaction.
Sec. 203. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.
Sec. 204. Penalty for understatements attributable to transactions lacking economic substance, etc.
Sec. 205. Modifications of substantial understatement penalty for nonreportable transactions.
Sec. 206. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
Sec. 207. Disclosure of reportable transactions.
Sec. 208. Modifications to penalty for failure to register tax shelters.
Sec. 209. Modification of penalty for failure to maintain lists of investors.
Sec. 210. Penalty on promoters of tax shelters.
Sec. 211. Increases in penalties for aiding and abetting understatements.

Subtitle B—Enron-Related Tax Shelter Provisions

Sec. 221. Limitation on transfer or importation of built-in losses.
Sec. 222. No reduction of basis under section 734 in stock held by partnership in corporate partner.
Sec. 223. Expanded disallowance of deduction for interest on convertible debt.
Sec. 224. Expanded authority to disallow tax benefits under section 269.
Sec. 225. Modification of interaction between subpart F and passive foreign investment company rules.

SEC. 2. STATEMENT OF CONGRESSIONAL FINDINGS AND PURPOSES.

(a) **FINDINGS.**—The Congress finds the following:

(1) The current alternative minimum tax (hereinafter referred to as the “AMT”) was enacted in 1986 with the stated purpose of ensuring that individuals with relatively large incomes would pay some minimum amount of Federal income tax, notwithstanding the fact that the individuals could have used otherwise allowable tax preferences to reduce their regular tax to zero.

(2) The AMT, when enacted, affected a very small percentage of individuals. Approximately 0.1 percent of all individuals were subject to the AMT in 1987.

(3) During the 1990’s virtually all items that have been traditionally considered to be tax preferences were removed from the AMT.

(4) As a result, virtually all AMT liability now is attributable to 3 items that few people would consider to be tax preferences: the deduction for personal exemptions, the deduction for State and local taxes, and miscellaneous itemized deductions.

(5) In 1993, adjustments to minimum tax rates were made to correspond to adjustments made in regular income tax rates. The 1993 legislation also increased the amount of the AMT exemption.

(6) The percentage of individuals subject to the AMT did not increase as a result of the 1993 changes. The percentage in 1992 was 0.3 percent. It was 0.3 percent in 1994.

(7) The first significant increase in the percentage of individuals paying the AMT occurred by reason of the Taxpayer Relief Act of 1997. Some of the benefits of the capital gains tax reduction provided in the 1997 Act were taken back by the AMT. As a result of the 1997 Act, the percentage of individuals paying the AMT doubled in less than 2 years.

(8) Even after the impact of the 1997 Act, the number of individuals subject to the AMT was extremely small until the enactment of the tax reductions by the Economic Growth and Tax Relief Reconciliation Act of 2001. Less than 1 percent of individuals were subject to the AMT before 2001.

(9) The Economic Growth and Tax Relief Reconciliation Act of 2001 contained reductions in the regular income tax rates but not in the minimum tax rates. As a result, the number of individuals subject to the AMT is projected to skyrocket. In the future—

(A) 92 percent of all households with income between \$100,000 and \$500,000 will be subject to the minimum tax;

(B) 73 percent of households with income between \$75,000 and \$100,000 will be subject to the minimum tax; and

(C) 37 percent of households with income between \$50,000 and \$75,000 will be subject to the minimum tax.

(10) The AMT has a substantial marriage penalty that has never been addressed by recent “marriage penalty repeal” legislation. Married couples are 20 times more likely to be on the minimum tax than single individuals.

(11) More than one-half of the promised tax reductions in the recent marriage penalty bill passed by the House of Representatives will be taken back by the AMT.

(12) The AMT disproportionately applies to families with children. Ninety-seven percent of families with children and with incomes between \$75,000 and \$100,000 will be subject to the AMT.

(13) The current AMT means that many of the tax reductions enacted in 2001 and 2003 are essentially temporary regardless of whether Congress makes them permanent by repealing the sunset contained in the 2001 Act. On average, the AMT will take back—

(A) 15.3 percent of the benefits of the recent tax cuts from families with incomes between \$50,000 and \$70,000;

(B) 37.2 percent of the benefits from families with incomes between \$75,000 and \$100,000;

(C) 65 percent of the benefits from families with incomes between \$100,000 and \$200,000; and

(D) 71.8 percent of the benefits from families with incomes between \$200,000 and \$500,000.

(14) Only extremely wealthy taxpayers will retain most of the benefits of the recent tax cuts. Taxpayers making more than \$1,000,000 will find only 8 percent of their tax reductions taken back by the AMT.

(15) The Bush Administration's Fiscal Year 2005 Budget recommends that the recent tax reductions be made permanent. Accomplishing that goal requires a total reform of the AMT.

(b) PURPOSE.—It is the purpose of this Act to—

(1) provide significant temporary relief from the alternative minimum tax; and

(2) to provide a framework for a total reform of the alternative minimum tax.

TITLE I—TEMPORARY RELIEF FROM THE ALTERNATIVE MINIMUM TAX; FRAMEWORK FOR REFORM

SEC. 101. TEMPORARY RELIEF FROM THE ALTERNATIVE MINIMUM TAX.

(a) IN GENERAL.—Section 55 (relating to alternative minimum tax imposed) is amended by adding at the end the following new subsection:

“(f) EXEMPTION FOR INDIVIDUALS FOR TAXABLE YEARS BEGINNING IN 2005.—For any taxable year beginning in 2005, in the case of an individual—

“(1) IN GENERAL.—The tentative minimum tax of the taxpayer shall be zero if the adjusted gross income of the taxpayer (as determined for purposes of the regular tax) is equal to or less than the threshold amount.

“(2) PHASEIN OF LIABILITY ABOVE EXEMPTION LEVEL.—In the case of a taxpayer whose adjusted gross income exceeds the threshold amount but does not exceed \$145,000 (\$290,000 in the case of a joint return), the tax imposed by subsection (a) shall be the amount which bears the same ratio to such tax (determined without regard to this subsection) as—

“(A) the excess of—

“(i) the adjusted gross income of the taxpayer (as determined for purposes of the regular tax), over

“(ii) the threshold amount, bears to

“(B) \$20,000 (\$40,000 in the case of a joint return).

“(3) THRESHOLD AMOUNT.—For purposes of this paragraph, the term ‘threshold amount’ means \$125,000 (\$250,000 in the case of a joint return).

“(4) ESTATES AND TRUSTS.—This subsection shall not apply to any estate or trust.”.

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

SEC. 102. FRAMEWORK FOR REFORM.

(a) **RECOMMENDATIONS BY THE SECRETARY OF THE TREASURY.**—Not later than 30 days after the enactment of this Act, the Secretary of the Treasury shall submit to the Committee on Ways and Means of the House of Representatives and to the Committee on Finance of the Senate detailed legislative recommendations designed to reform the alternative minimum tax. Unless the Secretary determines that it is not feasible, such recommendations shall include changes designed to ensure that the percentage of individuals paying the minimum tax would be reduced to the level in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (which is less than 1 percent). The Secretary shall include with such recommendations estimates of their revenue cost.

(b) **ACTION BY COMMITTEE ON WAYS AND MEANS.**—Not later than August 1, 2004, the Committee on Ways and Means of the House of Representatives shall report legislation providing permanent reform of the alternative minimum tax. Such legislation shall be designed so that the percentage of individuals subject to the minimum tax will be restored to the level in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (which is less than 1 percent).

TITLE II—RESTRICTIONS ON TAX SHELTERS

Subtitle A—Provisions Designed To Curtail Tax Shelters

SEC. 201. CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.

(a) **IN GENERAL.**—Section 7701 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

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

“(1) **GENERAL RULES.**—

“(A) **IN GENERAL.**—In any case in which a court determines that the economic substance doctrine is relevant for purposes of this title to a transaction (or series of transactions), such transaction (or series of transactions) shall have economic substance only if the requirements of this paragraph are met.

“(B) **DEFINITION OF ECONOMIC SUBSTANCE.**—For purposes of subparagraph (A)—

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

“(I) the transaction changes in a meaningful way (apart from Federal 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 reasonable means of accomplishing such purpose.

In applying subclause (II), a purpose of achieving a financial accounting benefit shall not be taken into account in determining whether a transaction has a substantial nontax purpose if the origin of such financial accounting benefit is a reduction of income tax.

“(ii) SPECIAL RULE WHERE TAXPAYER RELIES ON PROFIT POTENTIAL.—A transaction shall not be treated as having economic substance by reason of having a potential for profit unless—

“(I) the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected, and

“(II) the reasonably expected pre-tax profit from the transaction exceeds a risk-free rate of return.

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

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

“(A) SPECIAL RULES FOR FINANCING TRANSACTIONS.—The form of a transaction which is in substance the borrowing of money or the acquisition of financial capital directly or indirectly from a tax-indifferent party shall not be respected if the present value of the deductions to be claimed with respect to the transaction is substantially in excess of the present value of the anticipated economic returns of the person lending the money or providing the financial capital. A public offering shall be treated as a borrowing, or an acquisition of financial capital, from a tax-indifferent party if it is reasonably expected that at least 50 percent of the offering will be placed with tax-indifferent parties.

“(B) ARTIFICIAL INCOME SHIFTING AND BASIS ADJUSTMENTS.—The form of a transaction with a tax-indifferent party shall not be respected if—

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

“(ii) it results in a basis adjustment or shifting of basis on account of overstating the income or gain of the tax-indifferent party.

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

“(A) ECONOMIC SUBSTANCE DOCTRINE.—The term ‘economic substance doctrine’ means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

“(B) TAX-INDIFFERENT PARTY.—The term ‘tax-indifferent party’ means any person or entity not subject to tax imposed by subtitle A. A person shall be treated as a tax-indifferent party with respect to a transaction if the items taken into account with respect to the transaction have no

substantial impact on such person's liability under subtitle A.

“(C) EXCEPTION FOR PERSONAL TRANSACTIONS OF INDIVIDUALS.—In the case of an individual, this subsection shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

“(D) TREATMENT OF LESSORS.—In applying paragraph (1)(B)(ii) to the lessor of tangible property subject to a lease—

“(i) the expected net tax benefits with respect to the leased property shall not include the benefits of—

“(I) depreciation,

“(II) any tax credit, or

“(III) any other deduction as provided in guidance by the Secretary, and

“(ii) subclause (II) of paragraph (1)(B)(ii) shall be disregarded in determining whether any of such benefits are allowable.

“(4) OTHER COMMON LAW DOCTRINES NOT AFFECTED.—Except as specifically provided in this subsection, the provisions of this subsection shall not be construed as altering or supplanting any other rule of law, and the requirements of this subsection shall be construed as being in addition to any such other rule of law.

“(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection. Such regulations may include exemptions from the application of this subsection.”.

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

SEC. 202. PENALTY FOR FAILING TO DISCLOSE REPORTABLE TRANSACTION.

(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 OR STATEMENT.

“(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 paragraphs (2) and (3), the amount of the penalty under subsection (a) shall be \$50,000.

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

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

“(A) IN GENERAL.—In the case of a failure under subsection (a) by—

“(i) a large entity, or

“(ii) a high net worth individual,

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

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

“(C) HIGH NET WORTH INDIVIDUAL.—For purposes of subparagraph (A), the term ‘high net worth individual’ means, with respect to a reportable transaction, a natural person whose net worth exceeds \$2,000,000 immediately before the transaction.

“(c) 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 included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.

“(2) LISTED TRANSACTION.—Except as provided in regulations, the term ‘listed transaction’ means a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011.

“(d) AUTHORITY TO RESCIND PENALTY.—

“(1) IN GENERAL.—The Commissioner of Internal 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 reportable transaction other than a listed transaction,

“(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 the Commissioner’s 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 facts and circumstances of the transaction,
- “(B) the reasons for the rescission, and
- “(C) the amount of the penalty rescinded.

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

- “(A) a summary of the total number and aggregate amount of penalties imposed, and rescinded, under this section, and
- “(B) a description of each penalty rescinded under this subsection and the reasons therefor.

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

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

“(2) which—

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

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

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

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

“(f) COORDINATION WITH OTHER PENALTIES.—The penalty imposed by this section is in addition to any penalty imposed under 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 or statement.”.

(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.

SEC. 203. ACCURACY-RELATED PENALTY FOR LISTED TRANSACTIONS AND OTHER REPORTABLE TRANSACTIONS HAVING A SIGNIFICANT TAX AVOIDANCE PURPOSE.

(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 treatment 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 LISTED AND OTHER AVOIDANCE TRANSACTIONS.—

“(1) IN GENERAL.—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.

“(2) RULES APPLICABLE TO ASSERTION AND COMPROMISE OF PENALTY.—

“(A) IN GENERAL.—Only upon the approval by the Chief Counsel for the Internal Revenue Service or the Chief Counsel’s delegate at the national office of the Internal Revenue Service may a penalty to which paragraph (1) applies be included in a 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals. If such a letter is provided to the taxpayer, only the Commissioner of Internal Revenue may compromise all or any portion of such penalty.

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

“(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 understatement 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 transaction understatements and noneconomic substance transaction understatements.

“(2) COORDINATION WITH OTHER PENALTIES.—

“(A) APPLICATION OF FRAUD PENALTY.—References to an underpayment in section 6663 shall be treated as including references to a reportable transaction understatement and a noneconomic substance transaction understatement.

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

“(3) SPECIAL RULE FOR AMENDED RETURNS.—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 such term by section 6662B(c).

“(5) CROSS REFERENCE.—

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

(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.

A taxpayer failing to adequately disclose in accordance with section 6011 shall be treated as meeting the requirements of subparagraph (A) if the penalty for such failure was rescinded under section 6707A(d).

“(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 respect 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 audited, 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 RELIED UPON.—

“(i) IN GENERAL.—An opinion of a tax advisor may not be relied upon to 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)) who participates in the organization, management, promotion, or sale of the transaction or who 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,

“(IV) has an arrangement with respect to the transaction which provides that contractual disputes between the taxpayer and the advisor are to be settled by arbitration or which limits damages by reference to fees paid to the advisor for such transaction, or

“(V) as determined under regulations prescribed by the Secretary, has a disqualifying 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,

“(IV) is not signed by all individuals who are principal authors of the opinion, or

“(V) fails to meet any other requirement as the Secretary may prescribe.”.

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

(d) CONFORMING AMENDMENTS.—

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

(2) Paragraph (3) of section 1274(b) is amended—

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

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

“(C) TAX SHELTER.—For purposes of subparagraph (B), 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.”.

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

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

(5) Subsection (b) of section 7525 is amended by striking “section 6662(d)(2)(C)(iii)” and inserting “section 1274(b)(3)(C)”.

(6)(A) The heading for section 6662 is amended to read as follows:

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

(B) 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.”.

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

SEC. 204. 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 a 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 the return or a statement attached to the return.

“(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 section 6662A were applied by taking into account items attributable to noneconomic substance transactions rather than items to which section 6662A would apply without regard to this paragraph.

“(2) **NONECONOMIC SUBSTANCE TRANSACTION.**—The term ‘noneconomic substance transaction’ means any transaction if—

“(A) there is a lack of economic substance (within the meaning of section 7701(n)(1)) for the transaction giving rise to the claimed benefit or the transaction was not respected under section 7701(n)(2), or

“(B) the transaction fails to meet the requirements of any similar rule of law.

“(d) **RULES APPLICABLE TO COMPROMISE OF PENALTY.**—

“(1) **IN GENERAL.**—If the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals has been sent with respect to a penalty to which this section applies, only the Commissioner of Internal Revenue may compromise all or any portion of such penalty.

“(2) **APPLICABLE RULES.**—The rules of paragraphs (2), (3), (4), and (5) of section 6707A(d) shall apply for purposes of paragraph (1).

“(e) COORDINATION WITH OTHER PENALTIES.—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.

“(f) CROSS REFERENCES.—

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

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

(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.”.

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

SEC. 205. 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:

“(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.—

(1) IN GENERAL.—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”.

(2) CONFORMING AMENDMENT.—Section 6662(d) is amended by adding at the end the following new paragraph:

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

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

SEC. 206. 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 1274(b)(3)(C)).”.

(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. 207. 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, managing, promoting, selling, implementing, or carrying out any reportable transaction, and

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

“(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)(A) 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.

“(a) IN GENERAL.—Each material advisor (as defined in section 6111) with respect to any reportable transaction (as defined in section 6707A(c)) shall 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 such a material advisor with respect to such transaction, and
- “(2) containing such other information as the Secretary may by regulations require.

This section shall apply without regard to whether a material advisor is required to file a return under section 6111 with respect to such transaction.”.

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

(C) Section 6112(b), as redesignated by subparagraph (B), is amended—

- (i) by inserting “written” before “request” in paragraph (1)(A), and
- (ii) by striking “shall prescribe” in paragraph (2) and inserting “may prescribe”.

- (D) 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.”.

- (3)(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) REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM OF CONFIDENTIALITY.—Subparagraph (A) of section 6112(b)(1), as redesignated by subsection (b)(2)(B), is amended by adding at the end the following new flush sentence:

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

(d) **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. 208. MODIFICATIONS TO PENALTY FOR FAILURE TO REGISTER TAX SHELTERS.

(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 including the transaction 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) **CERTAIN RULES TO APPLY.**—The provisions of section 6707A(d) shall apply to any penalty imposed under this section.

“(d) **REPORTABLE AND LISTED TRANSACTIONS.**—The terms ‘reportable transaction’ and ‘listed transaction’ have the respective meanings given to such terms by section 6707A(c).”.

(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. 209. 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)(1)(A) within 20 business days after the date of the Secretary's 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. 210. PENALTY ON PROMOTERS OF TAX SHELTERS.

(a) PENALTY ON PROMOTING ABUSIVE TAX SHELTERS.—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 described 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.

SEC. 211. INCREASES IN PENALTIES FOR AIDING AND ABETTING UNDERSTATEMENTS.

(a) IN GENERAL.—Section 6701(b) is amended to read as follows:

“(b) AMOUNT OF PENALTY.—

“(1) IN GENERAL.—The amount of the penalty imposed by subsection (a) shall be the greater of—

“(A) \$2,000, or

“(B) 50 percent of the gross income derived (or to be derived) from the activity giving rise to the penalty.

“(2) CORPORATIONS.—If the return, affidavit, claim, or other document relates to the tax liability of a corporation, paragraph (1)(A) shall be applied by substituting ‘\$20,000’ for ‘\$2,000’.”

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

Subtitle B—Enron-Related Tax Shelter Provisions

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

(a) IN GENERAL.—Section 362 (relating to basis to corporations) is amended by adding at the end the following new subsection:

“(e) LIMITATIONS ON BUILT-IN LOSSES.—

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

“(A) IN GENERAL.—If in any transaction described in subsection (a) or (b) there would (but for this subsection) be an importation of a net built-in loss, the basis of each property described in subparagraph (B) which is acquired in such transaction shall (notwithstanding subsections (a) and (b)) be its fair market value immediately after such transaction.

“(B) PROPERTY DESCRIBED.—For purposes of subparagraph (A), property is described in this subparagraph if—

“(i) gain or loss with respect to such property is not subject to tax under this subtitle in the hands of the transferor immediately before the transfer, and

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

In any case in which the transferor is a partnership, the preceding sentence shall be applied by treating each partner in such partnership as holding such partner's proportionate share of the property of such partnership.

“(C) IMPORTATION OF NET BUILT-IN LOSS.—For purposes of subparagraph (A), there is an importation of a net built-in loss in a transaction if the transferee's aggregate adjusted bases of property described in subparagraph (B) which is transferred in such transaction would (but for this paragraph) exceed the fair market value of such property immediately after such transaction.

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

“(A) IN GENERAL.—If—

“(i) property is transferred by a transferor in any transaction which is described in subsection (a) and which is not described in paragraph (1) of this subsection, and

“(ii) the transferee's aggregate adjusted bases of such property so transferred would (but for this paragraph) exceed the fair market value of such property immediately after such transaction,

then, notwithstanding subsection (a), the transferee's aggregate adjusted bases of the property so transferred shall not exceed the fair market value of such property immediately after such transaction.

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

“(C) EXCEPTION FOR TRANSFERS WITHIN AFFILIATED GROUP.—Subparagraph (A) shall not apply to any transaction if the transferor owns stock in the transferee meeting the requirements of section 1504(a)(2). In the case of property to which subparagraph (A) does not apply by reason of the preceding sentence, the transferor's basis in the stock received for such property shall not exceed its fair market value immediately after the transfer.”.

(b) COMPARABLE TREATMENT WHERE LIQUIDATION.—Paragraph (1) of section 334(b) (relating to liquidation of subsidiary) is amended to read as follows:

“(1) IN GENERAL.—If property is received by a corporate distributee in a distribution in a complete liquidation to which section 332 applies (or in a transfer described in section 337(b)(1)), the basis of such property in the hands of such distributee shall be the same as it would be in the hands of the transferor; except that the basis of such property in the hands

of such distributee shall be the fair market value of the property at the time of the distribution—

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

“(B) in any case in which the liquidating corporation is a foreign corporation, the corporate distributee is a domestic corporation, and the corporate distributee’s aggregate adjusted bases of property described in section 362(e)(1)(B) which is distributed in such liquidation would (but for this subparagraph) exceed the fair market value of such property immediately after such liquidation.”.

(c) **EFFECTIVE DATES.**—

(1) **IN GENERAL.**—The amendment made by subsection (a) shall apply to transactions after the date of the enactment of this Act.

(2) **LIQUIDATIONS.**—The amendment made by subsection (b) shall apply to liquidations after the date of the enactment of this Act.

SEC. 222. NO REDUCTION OF BASIS UNDER SECTION 734 IN STOCK HELD BY PARTNERSHIP IN CORPORATE PARTNER.

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

“(c) **NO ALLOCATION OF BASIS DECREASE TO STOCK OF CORPORATE PARTNER.**—In making an allocation under subsection (a) of any decrease in the adjusted basis of partnership property under section 734(b)—

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

“(2) any amount not allocable to stock by reason of paragraph (1) shall be allocated under subsection (a) to other partnership property in such manner as the Secretary may prescribe.

Gain shall be recognized to the partnership to the extent that the amount required to be allocated under paragraph (2) to other partnership property exceeds the aggregate adjusted basis of such other property immediately before the allocation required by paragraph (2).”.

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

SEC. 223. EXPANDED DISALLOWANCE OF DEDUCTION FOR INTEREST ON CONVERTIBLE DEBT.

(a) **IN GENERAL.**—Paragraph (2) of section 163(l) is amended by inserting “or equity held by the issuer (or any related party) in any other person” after “or a related party”.

(b) **CAPITALIZATION ALLOWED WITH RESPECT TO EQUITY OF PERSONS OTHER THAN ISSUER AND RELATED PARTIES.**—Section 163(l) is amended by redesignating paragraphs (4) and (5) as paragraphs (5) and (6) and by inserting after paragraph (3) the following new paragraph:

“(4) **CAPITALIZATION ALLOWED WITH RESPECT TO EQUITY OF PERSONS OTHER THAN ISSUER AND RELATED PARTIES.**—If the disqualified debt instrument of a corporation is payable in eq-

uity held by the issuer (or any related party) in any other person (other than a related party), the basis of such equity shall be increased by the amount not allowed as a deduction by reason of paragraph (1) with respect to the instrument.”.

(c) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED BY DEALERS IN SECURITIES.—Section 163(l), as amended by subsection (b), is amended by redesignating paragraphs (5) and (6) as paragraphs (6) and (7) and by inserting after paragraph (4) the following new paragraph:

“(5) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED BY DEALERS IN SECURITIES.—For purposes of this subsection, the term ‘disqualified debt instrument’ does not include indebtedness issued by a dealer in securities (or a related party) which is payable in, or by reference to, equity (other than equity of the issuer or a related party) held by such dealer in its capacity as a dealer in securities. For purposes of this paragraph, the term ‘dealer in securities’ has the meaning given such term by section 475.”.

(c) CONFORMING AMENDMENTS.—Paragraph (3) of section 163(l) is amended—

(1) by striking “or a related party” in the material preceding subparagraph (A) and inserting “or any other person”, and

(2) by striking “or interest” each place it appears.

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

SEC. 224. EXPANDED AUTHORITY TO DISALLOW TAX BENEFITS UNDER SECTION 269.

(a) IN GENERAL.—Subsection (a) of section 269 (relating to acquisitions made to evade or avoid income tax) is amended to read as follows:

“(a) IN GENERAL.—If—

“(1)(A) any person or persons acquire, directly or indirectly, control of a corporation, or

“(B) any corporation acquires, directly or indirectly, property of another corporation and the basis of such property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and

“(2) the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax,

then the Secretary may disallow such deduction, credit, or other allowance. For purposes of paragraph (1)(A), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of all shares of all classes of stock of the corporation.”.

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

SEC. 225. MODIFICATION OF INTERACTION BETWEEN SUBPART F AND PASSIVE FOREIGN INVESTMENT COMPANY RULES.

(a) LIMITATION ON EXCEPTION FROM PFIC RULES FOR UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS.—Paragraph (2) of section 1297(e) (relating to passive foreign invest-

ment company) is amended by adding at the end the following flush sentence:

“Such term shall not include any period if the earning of subpart F income by such corporation during such period would result in only a remote likelihood of an inclusion in gross income under section 951(a)(1)(A)(i).”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of controlled foreign corporations beginning after the date of the enactment of this Act, and to taxable years of United States shareholders with or within which such taxable years of controlled foreign corporations end.

Amend the title so as to read: “A bill to provide for significant temporary relief from the alternative minimum tax and for a framework for a total reform of the alternative minimum tax.”.

