

1 **“(B) the treatment of any member**
2 **of a foreign controlled group of enti-**
3 **ties as the common parent of such**
4 **group if such treatment is appro-**
5 **priate taking into account the eco-**
6 **nomical relationships among such enti-**
7 **ties.”.**

8 **(b) EFFECTIVE DATE.—The amendment**
9 **made by this section shall apply to payments**
10 **made after the date of the enactment of this**
11 **Act.**

12 **SEC. 452. CODIFICATION OF ECONOMIC SUBSTANCE DOC-**
13 **TRINE.**

14 **(a) IN GENERAL.—Section 7701 of the Inter-**
15 **nal Revenue Code of 1986 is amended by re-**
16 **designating subsection (o) as subsection (p)**
17 **and by inserting after subsection (n) the fol-**
18 **lowing new subsection:**

19 **“(o) CLARIFICATION OF ECONOMIC SUB-**
20 **STANCE DOCTRINE.—**

21 **“(1) APPLICATION OF DOCTRINE.—In the**
22 **case of any transaction to which the eco-**
23 **nomical substance doctrine is relevant,**
24 **such transaction shall be treated as hav-**
25 **ing economic substance only if—**

1 **“(A) the transaction changes in a**
2 **meaningful way (apart from Federal**
3 **income tax effects) the taxpayer’s eco-**
4 **nom ic position, and**

5 **“(B) the taxpayer has a substan-**
6 **tial purpose (apart from Federal in-**
7 **come tax effects) for entering into**
8 **such transaction.**

9 **“(2) SPECIAL RULE WHERE TAXPAYER RE-**
10 **LIES ON PROFIT POTENTIAL.—**

11 **“(A) IN GENERAL.—The potential**
12 **for profit of a transaction shall be**
13 **taken into account in determining**
14 **whether the requirements of subpara-**
15 **graphs (A) and (B) of paragraph (1)**
16 **are met with respect to the trans-**
17 **action only if the present value of the**
18 **reasonably expected pre-tax profit**
19 **from the transaction is substantial in**
20 **relation to the present value of the**
21 **expected net tax benefits that would**
22 **be allowed if the transaction were re-**
23 **spected.**

24 **“(B) TREATMENT OF FEES AND FOR-**
25 **EIGN TAXES.—Fees and other trans-**

1 **action expenses and foreign taxes**
2 **shall be taken into account as ex-**
3 **penditures in determining pre-tax profit**
4 **under subparagraph (A).**

5 **“(3) STATE AND LOCAL TAX BENEFITS.—**
6 **For purposes of paragraph (1), any State**
7 **or local income tax effect which is re-**
8 **lated to a Federal income tax effect shall**
9 **be treated in the same manner as a Fed-**
10 **eral income tax effect.**

11 **“(4) FINANCIAL ACCOUNTING BENEFITS.—**
12 **For purposes of paragraph (1)(B), achiev-**
13 **ing a financial accounting benefit shall**
14 **not be taken into account as a purpose**
15 **for entering into a transaction if the ori-**
16 **gin of such financial accounting benefit**
17 **is a reduction of Federal income tax.**

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

20 **“(A) ECONOMIC SUBSTANCE DOC-**
21 **TRINE.—The term ‘economic substance**
22 **doctrine’ means the common law doc-**
23 **trine under which tax benefits under**
24 **subtitle A with respect to a trans-**
25 **action are not allowable if the trans-**

1 **action does not have economic sub-**
2 **stance or lacks a business purpose.**

3 **“(B) EXCEPTION FOR PERSONAL**
4 **TRANSACTIONS OF INDIVIDUALS.—In the**
5 **case of an individual, paragraph (1)**
6 **shall apply only to transactions en-**
7 **tered into in connection with a trade**
8 **or business or an activity engaged in**
9 **for the production of income.**

10 **“(C) OTHER COMMON LAW DOC-**
11 **TRINES NOT AFFECTED.—Except as spe-**
12 **cifically provided in this subsection,**
13 **the provisions of this subsection shall**
14 **not be construed as altering or sup-**
15 **planting any other rule of law, and**
16 **the requirements of this subsection**
17 **shall be construed as being in addi-**
18 **tion to any such other rule of law.**

19 **“(D) DETERMINATION OF APPLICA-**
20 **TION OF DOCTRINE NOT AFFECTED.—The**
21 **determination of whether the eco-**
22 **nomical substance doctrine is relevant**
23 **to a transaction (or series of trans-**
24 **actions) shall be made in the same**

1 manner as if this subsection had
2 never been enacted.

3 **“(6) REGULATIONS.—The Secretary**
4 **shall prescribe such regulations as may**
5 **be necessary or appropriate to carry out**
6 **the purposes of this subsection.”.**

7 **(b) EFFECTIVE DATE.—The amendments**
8 **made by this section shall apply to trans-**
9 **actions entered into after the date of the en-**
10 **actment of this Act.**

11 **SEC. 453. PENALTIES FOR UNDERPAYMENTS.**

12 **(a) PENALTY FOR UNDERPAYMENTS ATTRIB-**
13 **UTABLE TO TRANSACTIONS LACKING ECONOMIC**
14 **SUBSTANCE.—**

15 **(1) IN GENERAL.—Subsection (b) of sec-**
16 **tion 6662 of the Internal Revenue Code of**
17 **1986 is amended by inserting after para-**
18 **graph (5) the following new paragraph:**

19 **“(6) Any disallowance of claimed tax**
20 **benefits by reason of a transaction lack-**
21 **ing economic substance (within the**
22 **meaning of section 7701(o)) or failing to**
23 **meet the requirements of any similar rule**
24 **of law.”.**