

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 nomic 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.”.**