To restrict the use of abusive tax shelters and offshore tax havens to inappropriately avoid Federal taxation, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 29, 2005

Mr. LEVIN (for himself, Mr. COLEMAN, and Mr. OBAMA) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To restrict the use of abusive tax shelters and offshore tax havens to inappropriately avoid Federal taxation, and for other purposes.

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

SECTION 1. SHORT TITLE; ETC.

(a) Short Title.—This Act may be cited as the “Tax Shelter and Tax Haven Reform Act of 2005”.

(b) Amendment of 1986 Code.—Except as other-
wise expressly provided, whenever in this Act an amend-
ment 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.**—The table of contents for this Act is as follows:

Sec. 1. Short title; etc.

**TITLE I—STRENGTHENING TAX SHELTER PENALTIES**

Sec. 101. Penalty for promoting abusive tax shelters.
Sec. 102. Penalty for aiding and abetting the understatement of tax liability.

**TITLE II—PREVENTING ABUSIVE TAX SHELTERS**

Sec. 201. Prohibited fee arrangement.
Sec. 202. Preventing tax shelter activities by financial institutions.
Sec. 203. Information sharing for enforcement purposes.
Sec. 204. Disclosure of information to Congress.
Sec. 205. Tax opinion standards for tax practitioners.
Sec. 206. Whistleblower reforms.
Sec. 207. Denial of deduction for certain fines, penalties, and other amounts.
Sec. 208. Sense of the Senate on tax enforcement priorities.

**TITLE III—REQUIRING ECONOMIC SUBSTANCE**

Sec. 301. Clarification of economic substance doctrine.
Sec. 302. Penalty for understatements attributable to transactions lacking economic substance, etc.
Sec. 303. Denial of deduction for interest on underpayments attributable to noneconomic substance transactions.

**TITLE IV—DETERRING UNCOOPERATIVE TAX HAVENS**

Sec. 401. Disclosing payments to persons in uncooperative tax havens.
Sec. 402. Deterring uncooperative tax havens by restricting allowable tax benefits.
Sec. 403.Doubling of certain penalties, fines, and interest on underpayments related to certain offshore financial arrangements.
Sec. 404. Treasury regulations on foreign tax credit.
TITLE I—STRENGTHENING TAX SHELTER PENALTIES

SEC. 101. PENALTY FOR PROMOTING ABUSIVE TAX SHELTERS.

(a) Penalty for Promoting Abusive Tax Shelters.—Section 6700 (relating to promoting abusive tax shelters, etc.) is amended—

(1) by redesignating subsections (b) and (c) as subsections (d) and (e), respectively,

(2) by striking “a penalty” and all that follows through the period in the first sentence of subsection (a) and inserting “a penalty determined under subsection (b)”, and

(3) by inserting after subsection (a) the following new subsections:

“(b) Amount of Penalty; Calculation of Penalty; Liability for Penalty.—

“(1) Amount of penalty.—The amount of the penalty imposed by subsection (a) shall not exceed the greater of—

“(A) 150 percent of the gross income derived (or to be derived) from such activity by the person or persons subject to such penalty, and
“(B) if readily subject to calculation, the
total amount of underpayment by the taxpayer
(including penalties, interest, and taxes) in con-
nection with such activity.

“(2) CALCULATION OF PENALTY.—The penalty
amount determined under paragraph (1) shall be
calculated with respect to each instance of an activ-
ity described in subsection (a), each instance in
which income was derived by the person or persons
subject to such penalty, and each person who par-
ticipated in such an activity.

“(3) LIABILITY FOR PENALTY.—If more than 1
person is liable under subsection (a) with respect to
such activity, all such persons shall be jointly and
severally liable for the penalty under such sub-
section.

“(c) PENALTY NOT DEDUCTIBLE.—The payment of
any penalty imposed under this section or the payment
of any amount to settle or avoid the imposition of such
penalty shall not be considered an ordinary and necessary
expense in carrying on a trade or business for purposes
of this title and shall not be deductible by the person who
is subject to such penalty or who makes such payment.”.

(b) CONFORMING AMENDMENT.—Section 6700(a) is
amended by striking the last sentence.
(c) Effective Date.—The amendments made by this section shall apply to activities after the date of the enactment of this Act.

SEC. 102. PENALTY FOR AIDING AND ABETTING THE UNDERSTATEMENT OF TAX LIABILITY.

(a) In General.—Section 6701(a) (relating to imposition of penalty) is amended—

(1) by inserting “the tax liability or” after “respect to,” in paragraph (1),

(2) by inserting “aid, assistance, procurement, or advice with respect to such” before “portion” both places it appears in paragraphs (2) and (3), and

(3) by inserting “instance of aid, assistance, procurement, or advice or each such” before “document” in the matter following paragraph (3).

(b) Amount of Penalty.—Subsection (b) of section 6701 (relating to penalties for aiding and abetting understatement of tax liability) is amended to read as follows:

“(b) Amount of Penalty; Calculation of Penalty; Liability for Penalty.—

“(1) Amount of Penalty.—The amount of the penalty imposed by subsection (a) shall not exceed the greater of—
“(A) 150 percent of the gross income derived (or to be derived) from such aid, assistance, procurement, or advice provided by the person or persons subject to such penalty, and

“(B) if readily subject to calculation, the total amount of underpayment by the taxpayer (including penalties, interest, and taxes) in connection with the understatement of the liability for tax.

“(2) CALCULATION OF PENALTY.—The penalty amount determined under paragraph (1) shall be calculated with respect to each instance of aid, assistance, procurement, or advice described in subsection (a), each instance in which income was derived by the person or persons subject to such penalty, and each person who made such an understatement of the liability for tax.

“(3) LIABILITY FOR PENALTY.—If more than 1 person is liable under subsection (a) with respect to providing such aid, assistance, procurement, or advice, all such persons shall be jointly and severally liable for the penalty under such subsection.”.

(e) PENALTY NOT DEDUCTIBLE.—Section 6701 is amended by adding at the end the following new subsection: 
“(g) Penalty Not Deductible.—The payment of any penalty imposed under this section or the payment of any amount to settle or avoid the imposition of such penalty shall not be considered an ordinary and necessary expense in carrying on a trade or business for purposes of this title and shall not be deductible by the person who is subject to such penalty or who makes such payment.”.

(d) Effective Date.—The amendments made by this section shall apply to activities after the date of the enactment of this Act.

TITLE II—PREVENTING ABUSIVE TAX SHELTERS

SEC. 201. PROHIBITED FEE ARRANGEMENT.

(a) In General.—Section 6701, as amended by this Act, is amended—

(1) by redesignating subsections (f) and (g) as subsections (g) and (h), respectively,

(2) by striking “subsection (a).” in paragraphs (2) and (3) of subsection (g) (as redesignated by paragraph (1)) and inserting “subsection (a) or (f).”, and

(3) by inserting after subsection (e) the following new subsection:

“(f) Prohibited Fee Arrangement.—
“(1) IN GENERAL.—Any person who makes an agreement for, charges, or collects a fee which is for services provided in connection with the internal revenue laws, and the amount of which is calculated according to, or is dependent upon, a projected or actual amount of—

“(A) tax savings or benefits, or

“(B) losses which can be used to offset other taxable income,

shall pay a penalty with respect to each such fee activity in the amount determined under subsection (b).

“(2) RULES.—The Secretary may issue rules to carry out the purposes of this subsection and may provide exceptions for fee arrangements that are in the public interest.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to fee agreements, charges, and collections made after the date of the enactment of this Act.

SEC. 202. PREVENTING TAX SHELTER ACTIVITIES BY FINANCIAL INSTITUTIONS.

(a) EXAMINATIONS.—

(1) DEVELOPMENT OF EXAMINATION TECHNIQUES.—Each of the Federal banking agencies and
the Commission shall, in consultation with the Internal Revenue Service, develop examination techniques to detect potential violations of section 6700 or 6701 of the Internal Revenue Code of 1986, by depository institutions, brokers, dealers, and investment advisers, as appropriate.

(2) **FREQUENCY.**—Not less frequently than once in each 2-year period, each of the Federal banking agencies and the Commission shall implement the examination techniques developed under paragraph (1) with respect to each of the depository institutions, brokers, dealers, or investment advisers subject to their enforcement authority. Such examination shall, to the extent possible, be combined with any examination by such agency otherwise required or authorized by Federal law.

(b) **REPORT TO INTERNAL REVENUE SERVICE.**—In any case in which an examination conducted under this section with respect to a financial institution or other entity reveals a potential violation, such agency shall promptly notify the Internal Revenue Service of such potential violation for investigation and enforcement by the Internal Revenue Service in accordance with applicable provisions of law.
(c) REPORT TO CONGRESS.—The Federal banking agencies and the Commission shall submit a joint written report to Congress in 2007 and 2010 on their progress in preventing violations of sections 6700 and 6701 of the Internal Revenue Code of 1986, by depository institutions, brokers, dealers, and investment advisers, as appropriate.

(d) DEFINITIONS.—For purposes of this section—

(1) the terms “broker”, “dealer”, and “investment adviser” have the same meanings as in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c);

(2) the term “Commission” means the Securities and Exchange Commission;

(3) the term “depository institution” has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(4) the term “Federal banking agencies” has the same meaning as in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)); and

(5) the term “Secretary” means the Secretary of the Treasury.

SEC. 203. INFORMATION SHARING FOR ENFORCEMENT PURPOSES.

(a) PROMOTION OF PROHIBITED TAX SHELTERS OR TAX AVOIDANCE SCHEMES.—Section 6103(h) (relating to
disclosure to certain Federal officers and employees for purposes of tax administration, etc. is amended by adding at the end the following new paragraph:

“(7) Disclosure of returns and return information related to promotion of prohibited tax shelters or tax avoidance schemes.—

“(A) Written request.—Upon receipt by the Secretary of a written request which meets the requirements of subparagraph (B) from the head of the United States Securities and Exchange Commission, an appropriate Federal banking agency as defined under section 1813(q) of title 12, United States Code, or the Public Company Accounting Oversight Board, a return or return information shall be disclosed to such requestor’s officers and employees who are personally and directly engaged in an investigation, examination, or proceeding by such requestor to evaluate, determine, penalize, or deter conduct by a financial institution, issuer, or public accounting firm, or associated person, in connection with a potential or actual violation of section 6700 (promotion of abusive tax shelters), 6701 (aiding and abetting under-
statement of tax liability), or activities related
to promoting or facilitating inappropriate tax
avoidance or tax evasion. Such disclosure shall
be solely for use by such officers and employees
in such investigation, examination, or pro-
ceeding.

“(B) REQUIREMENTS.—A request meets
the requirements of this subparagraph if it sets
forth—

“(i) the nature of the investigation,
examination, or proceeding,

“(ii) the statutory authority under
which such investigation, examination, or
proceeding is being conducted,

“(iii) the name or names of the finan-
cial institution, issuer, or public accounting
firm to which such return information re-
lates,

“(iv) the taxable period or periods to
which such return information relates, and

“(v) the specific reason or reasons
why such disclosure is, or may be, relevant
to such investigation, examination or pro-
ceeding.
“(C) FINANCIAL INSTITUTION.—For the purposes of this paragraph, the term ‘financial institution’ means a depository institution, foreign bank, insured institution, industrial loan company, broker, dealer, investment company, investment advisor, or other entity subject to regulation or oversight by the United States Securities and Exchange Commission or an appropriate Federal banking agency.”.

(b) FINANCIAL AND ACCOUNTING FRAUD INVESTIGATIONS.—Section 6103(i) (relating to disclosure to Federal officers or employees for administration of Federal laws not relating to tax administration) is amended by adding at the end the following new paragraph:

“(9) DISCLOSURE OF RETURNS AND RETURN INFORMATION FOR USE IN FINANCIAL AND ACCOUNTING FRAUD INVESTIGATIONS.—

“(A) WRITTEN REQUEST.—Upon receipt by the Secretary of a written request which meets the requirements of subparagraph (B) from the head of the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board, a return or return information shall be disclosed to such requestor’s officers and employees who are per-
sonally and directly engaged in an investigation, examination, or proceeding by such requester to evaluate the accuracy of a financial statement or report or to determine whether to require a restatement, penalize, or deter conduct by an issuer, investment company, or public accounting firm, or associated person, in connection with a potential or actual violation of auditing standards or prohibitions against false or misleading statements or omissions in financial statements or reports. Such disclosure shall be solely for use by such officers and employees in such investigation, examination, or proceeding.

“(B) REQUIREMENTS.—A request meets the requirements of this subparagraph if it sets forth—

“(i) the nature of the investigation, examination, or proceeding,

“(ii) the statutory authority under which such investigation, examination, or proceeding is being conducted,

“(iii) the name or names of the issuer, investment company, or public accounting firm to which such return information relates,
“(iv) the taxable period or periods to which such return information relates, and
“(v) the specific reason or reasons why such disclosure is, or may be, relevant to such investigation, examination or proceeding.”.

(c) Effective Date.—The amendments made by this section shall apply to disclosures and to information and document requests made after the date of the enactment of this Act.

SEC. 204. DISCLOSURE OF INFORMATION TO CONGRESS.

(a) Disclosure by Tax Return Preparer.—

(1) In general.—Subparagraph (B) of section 7216(b)(1) (relating to disclosures) is amended to read as follows:

“(B) pursuant to any 1 of the following documents, if clearly identified:

“(i) The order of any Federal, State, or local court of record.

“(ii) A subpoena issued by a Federal or State grand jury.

“(iii) An administrative order, summons, or subpoena which is issued in the performance of its duties by—
“(I) any Federal agency, including Congress or any committee or subcommittee thereof, or

“(II) any State agency, body, or commission charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers.”.

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to disclosures made after the date of the enactment of this Act pursuant to any document in effect on or after such date.

(b) DISCLOSURE BY SECRETARY.—Paragraph (2) of section 6104(a) (relating to inspection of applications for tax exemption or notice of status) is amended to read as follows:

“(2) INSPECTION BY CONGRESS.—

“(A) IN GENERAL.—Upon receipt of a written request from a committee or subcommittee of Congress, copies of documents related to a determination by the Secretary to grant, deny, revoke, or restore an organization’s exemption from taxation under section 501 shall be provided to such committee or sub-
committee, including any application, notice of
status, or supporting information provided by
such organization to the Internal Revenue Serv-
ice; any letter, analysis, or other document pro-
duced by or for the Internal Revenue Service
evaluating, determining, explaining, or relating
to the tax exempt status of such organization
(other than returns, unless such returns are
available to the public under this section or sec-
tion 6103 or 6110); and any communication be-
tween the Internal Revenue Service and any
other party relating to the tax exempt status of
such organization.

“(B) ADDITIONAL INFORMATION.—Section
6103(f) shall apply with respect to—

“(i) the application for exemption of
any organization described in subsection
(c) or (d) of section 501 which is exempt
from taxation under section 501(a) for any
taxable year and any application referred
to in subparagraph (B) of subsection
(a)(1) of this section, and

“(ii) any other papers which are in
the possession of the Secretary and which
relate to such application,
as if such papers constituted returns.”

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to disclosures and to information and document requests made after the date of the enactment of this Act.

SEC. 205. TAX OPINION STANDARDS FOR TAX PRACTITIONERS.

Section 330(d) of title 31, United States Code, is amended to read as follows:

“(d) The Secretary of the Treasury shall impose standards applicable to the rendering of written advice with respect to any listed transaction or any entity, plan, arrangement, or other transaction which has a potential for tax avoidance or evasion. Such standards shall address, but not be limited to, the following issues:

“(1) Independence of the practitioner issuing such written advice from persons promoting, marketing, or recommending the subject of the advice.

“(2) Collaboration among practitioners, or between a practitioner and other party, which could result in such collaborating parties having a joint financial interest in the subject of the advice.

“(3) Avoidance of conflicts of interest which would impair auditor independence.
“(4) For written advice issued by a firm, standards for reviewing the advice and ensuring the consensus support of the firm for positions taken.

“(5) Reliance on reasonable factual representations by the taxpayer and other parties.

“(6) Appropriateness of the fees charged by the practitioner for the written advice.

“(7) Preventing practitioners and firms from aiding or abetting the understatement of tax liability by clients.

“(8) Banning the promotion of potentially abusive or illegal tax shelters.”.

SEC. 206. WHISTLEBLOWER REFORMS.

(a) In General.—Section 7623 (relating to expenses of detection of underpayments and fraud, etc.) is amended—

(1) by striking “The Secretary” and inserting “(a) In General.—The Secretary”,

(2) by striking “and” at the end of paragraph (1) and inserting “or”,

(3) by striking “(other than interest)”, and

(4) by adding at the end the following new subsections:

“(b) Awards to Whistleblowers.—
“(1) In general.—If the Secretary proceeds
with any administrative or judicial action described
in subsection (a) based on information brought to
the Secretary’s attention by an individual, such indi-
vidual shall, subject to paragraph (2), receive as an
award at least 15 percent but not more than 30 per-
cent of the collected proceeds (including penalties,
interest, additions to tax, and additional amounts)
resulting from the action (including any related ac-
tions) or from any settlement in response to such ac-
tion. The determination of the amount of such
award by the Whistleblower Office shall depend upon
the extent to which the individual substantially con-
tributed to such action, and shall be determined at
the sole discretion of the Whistleblower Office.

“(2) Award in case of less substantial
contribution.—

“(A) In general.—In the event the ac-
tion described in paragraph (1) is one which the
Whistleblower Office determines to be based
principally on disclosures of specific allegations
(other than information provided by the indi-
vidual described in paragraph (1)) resulting
from a judicial or administrative hearing, from
a governmental report, hearing, audit, or inves-
tigation, or from the news media, the Whistle-
blower Office may award such sums as it con-
siders appropriate, but in no case more than 10
percent of the collected proceeds (including pen-
alties, interest, additions to tax, and additional
amounts) resulting from the action (including
any related actions) or from any settlement in
response to such action, taking into account the
significance of the individual’s information and
the role of such individual and any legal rep-
resentative of such individual in contributing to
such action.

“(B) Nonapplication of paragraph
where individual is original source of
information.—Subparagraph (A) shall not
apply if the information resulting in the initi-
ation of the action described in paragraph (1)
was originally provided by the individual de-
scribed in paragraph (1).

“(3) Application of this subsection.—This
subsection shall apply with respect to any action—
“(A) against any taxpayer, but in the case
of any individual, only if such individual’s gross
income exceeds $200,000 for any taxable year
subject to such action, and
“(B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $20,000.

“(4) ADDITIONAL RULES.—

“(A) NO CONTRACT NECESSARY.—No contract with the Internal Revenue Service is necessary for any individual to receive an award under this subsection.

“(B) REPRESENTATION.—Any individual described in paragraph (1) or (2) may be represented by counsel.

“(C) AWARD NOT SUBJECT TO INDIVIDUAL ALTERNATIVE MINIMUM TAX.—No award received under this subsection shall be included in gross income for purposes of determining alternative minimum taxable income.

“(c) WHISTLEBLOWER OFFICE.—

“(1) IN GENERAL.—There is established in the Internal Revenue Service an office to be known as the ‘Whistleblower Office’ which—

“(A) shall analyze information received from any individual described in subsection (b) and either investigate the matter itself or assign it to the appropriate Internal Revenue Service office,
“(B) shall monitor any action taken with respect to such matter,

“(C) shall inform such individual that it has accepted the individual’s information for further review,

“(D) may require such individual and any legal representative of such individual to not disclose any information so provided,

“(E) may ask for additional assistance from such individual or any legal representative of such individual, and

“(F) shall determine the amount to be awarded to such individual under subsection (b).

“(2) FUNDING FOR OFFICE.—From the amounts available for expenditure under subsection (a), the Whistleblower Office shall be credited with an amount equal to the awards made under subsection (b). These funds shall be used to maintain the Whistleblower Office and also to reimburse other Internal Revenue Service offices for related costs, such as costs of investigation and collection.

“(3) REQUEST FOR ASSISTANCE.—

“(A) IN GENERAL.—Any assistance requested under paragraph (1)(E) shall be under
the direction and control of the Whistleblower Office or the office assigned to investigate the matter under subparagraph (A). To the extent the disclosure of any returns or return information to the individual or legal representative is required for the performance of such assistance, such disclosure shall be pursuant to a contract entered into between the Secretary and the recipients of such disclosure subject to section 6103(n).

“(B) FUNDING OF ASSISTANCE.—From the funds made available to the Whistleblower Office under paragraph (2), the Whistleblower Office may reimburse the costs incurred by any legal representative in providing assistance described in subparagraph (A).”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to information provided on or after the date of the enactment of this Act.

SEC. 207. DENIAL OF DEDUCTION FOR CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

(a) IN GENERAL.—Subsection (f) of section 162 (relating to trade or business expenses) is amended to read as follows:

“(f) FINES, PENALTIES, AND OTHER AMOUNTS.—
“(1) IN GENERAL.—Except as provided in paragraph (2), no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or entity described in paragraph (4) in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

“(2) EXCEPTION FOR AMOUNTS CONSTITUTING RESTITUTION.—Paragraph (1) shall not apply to any amount which—

“(A) the taxpayer establishes constitutes restitution (including remediation of property) for damage or harm caused by or which may be caused by the violation of any law or the potential violation of any law, and

“(B) is identified as restitution in the court order or settlement agreement.

Identification pursuant to subparagraph (B) alone shall not satisfy the requirement under subparagraph (A). This paragraph shall not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.
“(3) Exception for amounts paid or incurred as the result of certain court orders.—Paragraph (1) shall not apply to any amount paid or incurred by order of a court in a suit in which no government or entity described in paragraph (4) is a party.

“(4) Certain nongovernmental regulatory entities.—An entity is described in this paragraph if it is—

“(A) a nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)), or

“(B) to the extent provided in regulations, a nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.

“(5) Exception for taxes due.—Paragraph (1) shall not apply to any amount paid or incurred as taxes due.”.

(b) Effective Date.—The amendment made by this section shall apply to amounts paid or incurred on or after the date of the enactment of this Act, except that
such amendment shall not apply to amounts paid or in-
curred under any binding order or agreement entered into
before such date. Such exception shall not apply to an
order or agreement requiring court approval unless the ap-
proval was obtained before such date.

SEC. 208. SENSE OF THE SENATE ON TAX ENFORCEMENT

PRIORITIES.

It is the sense of the Senate that additional funds
should be appropriated for Internal Revenue Service en-
fforcement efforts and that the Internal Revenue Service
should devote proportionately more of its enforcement
funds—

(1) to combat the promotion of abusive tax
shelters for corporations and high net worth individ-
uals and the aiding and abetting of tax evasion,

(2) to stop accounting, law, and financial firms
involved in such promotion and aiding and abetting,
and

(3) to combat the use of offshore financial ac-
counts to conceal taxable income.
TITLE III—REQUIRING ECONOMIC SUBSTANCE

SEC. 301. CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.

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

“(o) 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 deter-
mining whether any of such benefits are allow-
allowable.

“(4) Other common law doctrines not af-
fected.—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 pre-
scribe such regulations as may be necessary or ap-
propriate to carry out the purposes of this sub-
section. 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. 302. PENALTY FOR UNDERSTATEMENTS ATTRIB-
UTABLE TO TRANSACTIONS LACKING ECO-
NOMIC 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 ATTRIB-
UTABLE TO TRANSACTIONS LACKING ECO-
NOMIC 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 under-
statement.

“(b) Reduction of Penalty for Disclosed
Transactions.—Subsection (a) shall be applied by sub-
stituting ‘20 percent’ for ‘40 percent’ with respect to the
portion of any noneconomic substance transaction under-
statement with respect to which the relevant facts affect-
ing the tax treatment of the item are adequately disclosed
in the return or a statement attached to the return.

“(c) Noneconomic Substance Transaction Un-
derstatement.—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 non-
economic 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(o)(1)) for the transaction giving rise to the claimed benefit or the transaction was not respected under section 7701(o)(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) and (3) 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 im-
posed 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(c).”.

(b) COORDINATION WITH OTHER UNDERSTATEMENTS AND PENALTIES.—

(1) The second sentence of section 6662(d)(2)(A) is amended by inserting “and without regard to items with respect to which a penalty is imposed by section 6662B” before the period at the end.

(2) Subsection (e) of section 6662A is amended—

(A) in paragraph (1), by inserting “and noneconomic substance transaction understatements” after “reportable transaction understatements” both places it appears,

(B) in paragraph (2)(A), by inserting “and a noneconomic substance transaction understatement” after “reportable transaction understatement”,

(C) in paragraph (2)(B), by inserting “6662B or” before “6663”,

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in paragraph (2)(C)(i), by inserting
“or section 6662B” before the period at the
end,

(E) in paragraph (2)(C)(ii), by inserting
“and section 6662B” after “This section”,

(F) in paragraph (3), by inserting “or non-
economic substance transaction understate-
ment” after “reportable transaction understate-
ment”, and

(G) by adding at the end the following new
paragraph:

“(4) NONECONOMIC SUBSTANCE TRANSACTION
UNDERSTATEMENT.—For purposes of this sub-
section, the term ‘noneconomic substance trans-
action understatevant’ has the meaning given such
term by section 6662B(c).”.

(3) Subsection (e) of section 6707A is amend-
ed—

(A) by striking “or” at the end of subpara-
graph (B), and

(B) by striking subparagraph (C) and in-
serting the following new subparagraphs:

“(C) is required to pay a penalty under
section 6662B with respect to any noneconomic
substance transaction, or
“(D) is required to pay a penalty under section 6662(h) with respect to any transaction and would (but for section 6662A(e)(2)(C)) have been subject to penalty under section 6662A at a rate prescribed under section 6662A(c) or under section 6662B,”.

(c) 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.”.

(d) Effective Date.—The amendments made by this section shall apply to transactions entered into after the date of the enactment of this Act.

SEC. 303. DENIAL OF DEDUCTION FOR INTEREST ON UNDERPAYMENTS ATTRIBUTABLE TO NON-ECONOMIC SUBSTANCE TRANSACTIONS.

(a) In General.—Section 163(m) (relating to interest on unpaid taxes attributable to nondisclosed reportable transactions) is amended—

(1) by striking “attributable” and all that follows and inserting the following: “attributable to—

“(1) the portion of any reportable transaction understatement (as defined in section 6662A(b))
with respect to which the requirement of section 6664(d)(2)(A) is not met, or
“(2) any noneconomic substance transaction understatement (as defined in section 6662B(c)).”,
and
(2) by inserting “AND NONECONOMIC SUBSTANCE TRANSACTIONS” after “TRANSACTIONS”.

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

TITLE IV—DETERRING UNCOOPERATIVE TAX HAVENS

SEC. 401. DISCLOSING PAYMENTS TO PERSONS IN UNCOOPERATIVE TAX HAVENS.

(a) IN GENERAL.—Subpart A of part III of subchapter A of chapter 61 is amended by inserting after section 6038C the following new section:

“SEC. 6038D. DETERRING UNCOOPERATIVE TAX HAVENS THROUGH LISTING AND REPORTING REQUIREMENTS.

“(a) IN GENERAL.—Each United States person who transfers money or other property directly or indirectly to any uncooperative tax haven, to any financial institution
licensed by or operating in any uncooperative tax haven, or to any person who is a resident of any uncooperative tax haven shall furnish to the Secretary, at such time and in such manner as the Secretary shall by regulation prescribe, such information with respect to such transfer as the Secretary may require.

“(b) EXCEPTIONS.—Subsection (a) shall not apply to a transfer by a United States person if the amount of money (and the fair market value of property) transferred is less than $10,000. Related transfers shall be treated as 1 transfer for purposes of this subsection.

“(c) UNCOOPERATIVE TAX HAVEN.—For purposes of this section—

“(1) IN GENERAL.—The term ‘uncooperative tax haven’ means any foreign jurisdiction which is identified on a list maintained by the Secretary under paragraph (2) as being a jurisdiction—

“(A) which imposes no or nominal taxation either generally or on specified classes of income, and

“(B) has corporate, business, bank, or tax secrecy or confidentiality rules and practices, or has ineffective information exchange practices which, in the judgment of the Secretary, effectively limit or restrict the ability of the United States person to obtain relevant information about such transfer.
States to obtain information relevant to the enforcement of this title.

“(2) MAINTENANCE OF LIST.—Not later than November 1 of each calendar year, the Secretary shall issue a list of foreign jurisdictions which the Secretary determines qualify as uncooperative tax havens under paragraph (1).

“(3) INEFFECTIVE INFORMATION EXCHANGE PRACTICES.—For purposes of paragraph (1), a jurisdiction shall be deemed to have ineffective information exchange practices if the Secretary determines that during any taxable year ending in the 12-month period preceding the issuance of the list under paragraph (2)—

“(A) the exchange of information between the United States and such jurisdiction was inadequate to prevent evasion or avoidance of United States income tax by United States persons or to enable the United States effectively to enforce this title, or

“(B) such jurisdiction was identified by an intergovernmental group or organization of which the United States is a member as uncooperative with international tax enforcement or
information exchange and the United States concurs in the determination.

“(d) Penalty for Failure to File Information.—If a United States person fails to furnish the information required by subsection (a) with respect to any transfer within the time prescribed therefor (including extensions), such United States person shall pay (upon notice and demand by the Secretary and in the same manner as tax) an amount equal to 20 percent of the amount of such transfer.

“(e) Simplified Reporting.—The Secretary may by regulations provide for simplified reporting under this section for United States persons making large volumes of similar payments.

“(f) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.”.

(b) Clerical Amendment.—The table of sections for such subpart A is amended by inserting after the item relating to section 6038C the following new item:

“Sec. 6038D. Deterring uncooperative tax havens through listing and reporting requirements.”.

(c) Effective Date.—The amendments made by this section shall apply to transfers after the date which is 180 days after the date of the enactment of this Act.
SEC. 402. DETERRING UNCOORDERATIVE TAX HAVENS BY

REstricting allowable tax benefits.

(a) Limitation on deferral.—

(1) In general.—Subsection (a) of section 952 (defining subpart F income) is amended by striking “and” at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting “, and”, and by inserting after paragraph (5) the following new paragraph:

“(6) an amount equal to the applicable fraction (as defined in subsection (e)) of the income of such corporation other than income which—

“(A) is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person under section 951 (other than by reason of this paragraph or paragraph (3)(A)(i)), or

“(B) is described in subsection (b).”.

(2) Applicable fraction.—Section 952 is amended by adding at the end the following new subsection:

“(e) Identified tax haven income which is subpart F income.—

“(1) In general.—For purposes of subsection (a)(6), the term ‘applicable fraction’ means the frac-
“(A) the numerator of which is the aggregate identified tax haven income for the taxable year, and

“(B) the denominator of which is the aggregate income for the taxable year which is from sources outside the United States.

“(2) IDENTIFIED TAX HAVEN INCOME.—For purposes of paragraph (1), the term ‘identified tax haven income’ means income for the taxable year which is attributable to a foreign jurisdiction for any period during which such jurisdiction has been identified as an uncooperative tax haven under section 6038D(e).

“(3) REGULATIONS.—The Secretary shall prescribe regulations similar to the regulations issued under section 999(e) to carry out the purposes of this subsection.”.

(b) DENIAL OF FOREIGN TAX CREDIT.—Section 901 (relating to taxes of foreign countries and of possessions of United States) is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

““(m) REDUCTION OF FOREIGN TAX CREDIT, ETC., FOR IDENTIFIED TAX HAVEN INCOME.—
“(1) IN GENERAL.—Notwithstanding any other provision of this part—

“(A) no credit shall be allowed under subsection (a) for any income, war profits, or excess profits taxes paid or accrued (or deemed paid under section 902 or 960) to any foreign jurisdiction if such taxes are with respect to income attributable to a period during which such jurisdiction has been identified as an uncooperative tax haven under section 6038D(c), and

“(B) subsections (a), (b), (c), and (d) of section 904 and sections 902 and 960 shall be applied separately with respect to all income of a taxpayer attributable to periods described in subparagraph (A) with respect to all such jurisdictions.

“(2) TAXES ALLOWED AS A DEDUCTION, ETC.—Sections 275 and 78 shall not apply to any tax which is not allowable as a credit under subsection (a) by reason of this subsection.

“(3) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations which treat income...
paid through 1 or more entities as derived from a foreign jurisdiction to which this subsection applies if such income was, without regard to such entities, derived from such jurisdiction.”.

(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. 403. DOUBLING OF CERTAIN PENALTIES, FINES, AND INTEREST ON UNDERPAYMENTS RELATED TO CERTAIN OFFSHORE FINANCIAL ARRANGEMENTS.

(a) DETERMINATION OF PENALTY.—

(1) IN GENERAL.—Notwithstanding any other provision of law, in the case of an applicable taxpayer—

(A) the determination as to whether any interest or applicable penalty is to be imposed with respect to any arrangement described in paragraph (2), or to any underpayment of Federal income tax attributable to items arising in connection with any such arrangement, shall be made without regard to the rules of subsections (b), (c), and (d) of section 6664 of the Internal Revenue Code of 1986, and
(B) if any such interest or applicable penalty is imposed, the amount of such interest or penalty shall be equal to twice that determined without regard to this section.

(2) APPLICABLE TAXPAYER.—For purposes of this subsection—

   (A) IN GENERAL.—The term “applicable taxpayer” means a taxpayer which—

       (i) has underreported its United States income tax liability with respect to any item which directly or indirectly involves—

           (I) any financial arrangement which in any manner relies on the use of an offshore payment mechanism (including credit, debit, or charge cards) issued by a bank or other entity in a foreign jurisdiction, or

           (II) any offshore financial arrangement (including any arrangement with foreign banks, financial institutions, corporations, partnerships, trusts, or other entities), and

       (ii) has not signed a closing agreement pursuant to the Voluntary Offshore
Compliance Initiative established by the Department of the Treasury under Revenue Procedure 2003–11 or voluntarily disclosed its participation in such arrangement by notifying the Internal Revenue Service of such arrangement prior to the issue being raised by the Internal Revenue Service during an examination.

(B) AUTHORITY TO WAIVE.—The Secretary of the Treasury or the Secretary's delegate may waive the application of paragraph (1) for any taxpayer if the Secretary or the Secretary's delegate determines that—

(i) the use of such offshore payment mechanism or financial arrangement was incidental to the transaction,

(ii) in the case of a trade or business, such use took place in the ordinary course of the trade or business of the taxpayer, and

(iii) such waiver would serve the public interest.

(C) ISSUES RAISED.—For purposes of subparagraph (A)(ii), an item shall be treated as
an issue raised during an examination if the individual examining the return—

(i) communicates to the taxpayer knowledge about the specific item, or

(ii) has made a request to the taxpayer for information and the taxpayer could not make a complete response to that request without giving the examiner knowledge of the specific item.

(b) Definitions and Rules.—For purposes of this section—

(1) Applicable Penalty.—The term “applicable penalty” means any penalty, addition to tax, or fine imposed under chapter 68 of the Internal Revenue Code of 1986.

(2) Fees and Expenses.—The Secretary of the Treasury may retain and use an amount not in excess of 25 percent of all additional interest, penalties, additions to tax, and fines collected under this section to be used for enforcement and collection activities of the Internal Revenue Service. The Secretary shall keep adequate records regarding amounts so retained and used. The amount credited as paid by any taxpayer shall be determined without regard to this paragraph.
(c) **Report by Secretary.**—The Secretary shall each year conduct a study and report to Congress on the implementation of this section during the preceding year, including statistics on the number of taxpayers affected by such implementation and the amount of interest and applicable penalties asserted, waived, and assessed during such preceding year.

(d) **Effective Date.**—The provisions of this section shall apply to interest, penalties, additions to tax, and fines with respect to any taxable year if, as of the date of the enactment of this Act, the assessment of any tax, penalty, or interest with respect to such taxable year is not prevented by the operation of any law or rule of law.

**SEC. 404. TREASURY REGULATIONS ON FOREIGN TAX CREDIT.**

(a) **In General.**—Section 901 (relating to taxes of foreign countries and of possessions of United States), as amended by section 402, is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

“(n) **Regulations.**—The Secretary may prescribe regulations disallowing a credit under subsection (a) for all or a portion of any foreign tax, or allocating a foreign tax among 2 or more persons, in cases where the foreign tax is imposed on any person in respect of income of another...
other person or in other cases involving the inappropriate separation of the foreign tax from the related foreign income.”.

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