

105TH CONGRESS
1ST SESSION

H. R. 2707

To amend the Internal Revenue Code of 1986 to permit tax-free reorganizations of specialized small business investment companies into partnerships and regulated investment companies, to expand the exclusion for gain from small business stock for such stock held by such companies, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 23, 1997

Mr. JEFFERSON (for himself, Mr. RANGEL, Mr. WYNN, Mr. CLYBURN, Ms. EDDIE BERNICE JOHNSON of Texas, Mr. FATTAH, Mr. TOWNS, Mr. ENGLISH of Pennsylvania, Ms. CHRISTIAN-GREEN, Mr. WATT of North Carolina, Mr. FORD, Ms. WATERS, Mr. FROST, Mrs. CLAYTON, Mr. LEWIS of Georgia, Mr. DAVIS of Illinois, Ms. NORTON, Ms. JACKSON-LEE of Texas, Mr. HILLIARD, Mr. McCRERY, Mr. FLAKE, Mr. THOMPSON, Mr. DELLUMS, Mr. SCOTT, Mr. CUMMINGS, Mr. PAYNE, Mrs. MEEK of Florida, Ms. KILPATRICK, Ms. CARSON, Mr. DIXON, Mr. STOKES, Mr. RUSH, Mr. CLAY, Mr. BISHOP, Ms. MILLENDER-McDONALD, Mr. OWENS, Mr. JACKSON of Illinois, Ms. McKINNEY, Mr. CONYERS, Mr. HASTINGS of Florida, and Ms. BROWN of Florida) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to permit tax-free reorganizations of specialized small business investment companies into partnerships and regulated investment companies, to expand the exclusion for gain from small business stock for such stock held by such companies, and for other purposes.

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

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Entrepreneurial Eq-
 5 uity Capital Formation Act”.

6 **TITLE I—TAX-FREE CONVER-**
 7 **SIONS OF SPECIALIZED**
 8 **SMALL BUSINESS INVEST-**
 9 **MENT COMPANIES INTO**
 10 **PASS-THRU ENTITIES**

11 **SEC. 101. MODIFICATIONS TO PROVISIONS RELATING TO**
 12 **REGULATED INVESTMENT COMPANIES.**

13 (a) IN GENERAL.—Section 851 of the Internal Reve-
 14 nue Code of 1986 (relating to definition of regulated in-
 15 vestment company) is amended by adding at the end the
 16 following new subsection:

17 “(i) SPECIAL RULES FOR SPECIALIZED SMALL BUSI-
 18 NESS INVESTMENT COMPANIES.—

19 “(1) IN GENERAL.—For purposes of determin-
 20 ing whether a specialized small business investment
 21 company is a regulated investment company for pur-
 22 poses of this subchapter—

23 “(A) income derived in connection with ac-
 24 tivities as a specialized small business invest-
 25 ment company (including compensation for

1 services rendered in connection with invest-
2 ments made as part of such activities) shall be
3 treated as qualifying income under subsection
4 (b)(2),

5 “(B) subsection (b)(3) shall not apply, and

6 “(C) the requirements of subsection (b)(4)
7 shall be treated as met if, at the close of each
8 quarter of the taxable year, at least 50 percent
9 of the value of its total assets is represented
10 by—

11 “(i) assets described in subsection
12 (b)(4)(A)(i), and

13 “(ii) other investments permitted
14 under the Small Business Investment Act
15 of 1958.

16 “(2) WAIVER OF DISTRIBUTION REQUIREMENT;
17 CERTAIN EARNINGS AND PROFITS DISREGARDED.—

18 In the case of a specialized small business invest-
19 ment company—

20 “(A) section 852(a)(1) and section 4982(a)
21 shall not apply, and

22 “(B) earning and profits accumulated
23 while the company is a specialized small busi-
24 ness investment company shall be disregarded
25 for purposes of section 852(a)(2).

1 “(3) SPECIALIZED SMALL BUSINESS INVEST-
2 MENT COMPANY.—For purposes of this subsection,
3 the term ‘specialized small business investment com-
4 pany’ means any corporation which—

5 “(A) as of September 30, 1996, held a li-
6 cense to operate under section 301(d) of the
7 Small Business Investment Act of 1958, or

8 “(B) holds a license from the Small Busi-
9 ness Administration, issued after such date, to
10 operate as a specialized small business invest-
11 ment company.”

12 (b) EFFECTIVE DATE.—The amendment made by
13 this section shall apply to taxable years beginning after
14 December 31, 1996.

15 **SEC. 102. TAX-FREE REORGANIZATION OF SPECIALIZED**
16 **SMALL BUSINESS INVESTMENT COMPANY AS**
17 **A PARTNERSHIP.**

18 (a) IN GENERAL.—If, during the 180-day period be-
19 ginning on the date of the enactment of this Act, a cor-
20 poration which is a specialized small business investment
21 company transfers substantially all of its assets to a part-
22 nership (including its license to operate as a specialized
23 small business investment company) solely in exchange for
24 partnership interests in such partnership, no gain or loss

1 shall be recognized to the corporation on such a transfer
2 if—

3 (1) immediately after such exchange, such cor-
4 poration holds partnership interests in such partner-
5 ship having a value equal to at least 80 percent of
6 the total value of all partnership interests in such
7 partnership, and

8 (2) before the close of such period, such cor-
9 poration transfers all partnership interests held by
10 the corporation in such partnership, and all remain-
11 ing assets of the corporation, to its shareholders in
12 the complete liquidation of such corporation.

13 If, prior to the date of enactment of this Act or at any
14 time before the close of the 120-day period beginning on
15 such date, a corporation files an application with the Small
16 Business Administration for approval of a transfer de-
17 scribed in the preceding sentence, the 180-day period re-
18 ferred to in the preceding sentence shall not expire before
19 the date which is 180 days after the date such Administra-
20 tion grants preliminary approval of such transfer.

21 (b) NONRECOGNITION OF GAIN OR LOSS TO COR-
22 PORATION ON DISTRIBUTION OF PARTNERSHIP INTER-
23 ESTS.—In the case of any distribution of a partnership
24 interest acquired by the liquidating corporation in an ex-
25 change to which subsection (a) applies—

1 (1) no gain or loss shall be recognized to the
2 liquidating corporation by reason of such distribu-
3 tion, and

4 (2) such distribution shall not be treated as a
5 sale or exchange for purposes of section
6 708(b)(1)(B) of the Internal Revenue Code of 1986.

7 (c) GAIN RECOGNIZED BY SHAREHOLDERS ON RE-
8 CEIPT OF PROPERTY OTHER THAN PARTNERSHIP INTER-
9 ESTS.—

10 (1) IN GENERAL.—No gain or loss shall be rec-
11 ognized to a shareholder of a corporation on the
12 transfer of such shareholder's stock in such corpora-
13 tion to such corporation solely in exchange for a
14 partnership interest in the partnership referred to in
15 subsection (a)(1).

16 (2) RECEIPT OF PROPERTY.—If paragraph (1)
17 would apply to an exchange but for the fact that
18 there is received, in addition to the partnership in-
19 terests permitted to be received under paragraph
20 (1), other property or money, then—

21 (A) gain (if any) to such recipient shall be
22 recognized, but not in excess of—

23 (i) the amount of money received, plus

24 (ii) the fair market value of such

25 other property received, and

1 (B) no loss to such recipient shall be rec-
2 ognized.

3 (d) BASIS.—The basis of property received in any ex-
4 change to which this section applies shall be determined
5 in accordance with rules similar to the rules of section 358
6 of the Internal Revenue Code of 1986.

7 (e) IMPOSITION OF TAX IN CERTAIN CASES.—If, at
8 any time during the 3-year period beginning on the date
9 of the transfer referred to in subsection (a) to a partner-
10 ship, such partnership ceases its investment activities or
11 ceases to have at least 75 percent of the value of its assets
12 (at cost) represented by investments permitted for special-
13 ized small business investment companies under the Small
14 Business Investment Act of 1958, there is hereby imposed
15 a tax on the income of such partnership equal to the ag-
16 gregate amount of tax which would have been imposed
17 under chapter 1 of the Internal Revenue Code of 1986
18 but for subsections (a) and (b). Any tax imposed by this
19 subsection shall be treated for purposes of such Code as
20 a tax imposed by chapter 1.

21 (f) SPECIALIZED SMALL BUSINESS INVESTMENT
22 COMPANY.—For purposes of this section, the term “spe-
23 cialized small business investment company” has the
24 meaning given such term by section 1202(k) of the Inter-
25 nal Revenue Code of 1986 (as added by this Act).

1 **TITLE II—ADDITIONAL INCEN-**
 2 **TIVES RELATED TO INVEST-**
 3 **ING IN SPECIALIZED SMALL**
 4 **BUSINESS INVESTMENT COM-**
 5 **PANIES**

6 **SEC. 201. EXPANSION OF NONRECOGNITION TREATMENT**
 7 **FOR SECURITIES GAIN ROLLED OVER INTO**
 8 **SPECIALIZED SMALL BUSINESS INVESTMENT**
 9 **COMPANIES.**

10 (a) EXTENSION OF ROLLOVER PERIOD.—Paragraph
 11 (1) of section 1044(a) of the Internal Revenue Code of
 12 1986 (relating to nonrecognition of gain) is amended by
 13 striking “60-day period” and inserting “180-day period”.

14 (b) INCREASE OF MAXIMUM EXCLUSION.—

15 (1) IN GENERAL.—Paragraphs (1) and (2) of
 16 section 1044(b) of such Code (relating to limita-
 17 tions) are amended to read as follows:

18 “(1) LIMITATION ON INDIVIDUALS.—In the
 19 case of an individual, the amount of gain which may
 20 be excluded under subsection (a) for any taxable
 21 year shall not exceed—

22 “(A) \$750,000, reduced by

23 “(B) the amount of gain excluded under
 24 subsection (a) for all preceding taxable years.

1 “(2) LIMITATION ON C CORPORATIONS.—In the
2 case of a C corporation, the amount of gain which
3 may be excluded under subsection (a) for any tax-
4 able year shall not exceed—

5 “(A) \$2,000,000, reduced by

6 “(B) the amount of gain excluded under
7 subsection (a) for all preceding taxable years.”

8 (2) CONFORMING AMENDMENT.—Subparagraph
9 (A) of section 1044(b)(3) of such Code (relating to
10 special rules for married individuals) is amended to
11 read as follows:

12 “(A) SEPARATE RETURNS.—In the case of
13 a separate return by a married individual, para-
14 graph (1) shall be applied by substituting
15 ‘\$375,000’ for ‘\$750,000’.”

16 (c) EXTENSION TO PREFERRED STOCK.—Paragraph
17 (1) of section 1044(a) of such Code is amended by striking
18 “common”.

19 (d) DEFINITION OF SPECIALIZED SMALL BUSINESS
20 INVESTMENT COMPANY.—Paragraph (3) of section
21 1044(c) of such Code (relating to definitions and special
22 rules) is amended to read as follows:

23 “(3) SPECIALIZED SMALL BUSINESS INVEST-
24 MENT COMPANY.—The term ‘specialized small busi-

1 ness investment company’ means any partnership or
2 corporation which—

3 “(A) as of September 30, 1996, is licensed
4 by the Small Business Administration under
5 section 301(d) of the Small Business Invest-
6 ment Act of 1958, or

7 “(B) holds a license from the Small Busi-
8 ness Administration, issued after such date, to
9 operate as a specialized small business invest-
10 ment company.”

11 (e) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to sales occurring after the date
13 of the enactment of this Act.

14 **SEC. 202. MODIFICATIONS TO EXCLUSION FOR GAIN FROM**
15 **QUALIFIED SMALL BUSINESS STOCK.**

16 (a) IN GENERAL.—Section 1202 of the Internal Rev-
17 enue Code of 1986 (relating to 50-percent exclusion for
18 gain from certain small business stock) is amended by re-
19 designating subsection (k) as subsection (l) and by insert-
20 ing after subsection (j) the following new subsection:

21 “(k) SPECIAL RULES FOR SPECIALIZED SMALL
22 BUSINESS INVESTMENT COMPANIES.—

23 “(1) INCREASE IN EXCLUSION; CORPORATE IN-
24 VESTORS ELIGIBLE.—In the case of—

1 “(A) the sale or exchange of stock in a
2 specialized small business investment company,
3 and

4 “(B) any amount treated under subsection
5 (g) or paragraph (2) of this subsection as gain
6 described in subsection (a) by reason of the
7 holding, sale, or exchange of an interest in a
8 specialized small business investment company,
9 subsection (a) shall be applied by substituting ‘60
10 percent’ for ‘50 percent’ and, in the case of interests
11 acquired after the date of the enactment of this sub-
12 section, without being limited to taxpayers other
13 than corporations.

14 “(2) EXCLUSION ALLOWABLE FOR CERTAIN
15 GAIN ON SALE OR EXCHANGE OF INTERESTS IN CER-
16 TAIN SPECIALIZED SMALL BUSINESS INVESTMENT
17 COMPANIES.—

18 “(A) IN GENERAL.—If any interest in a
19 specialized small business investment company
20 which is a pass-thru entity (as defined in sub-
21 section (g)(4)) is sold or exchanged, gain on
22 such sale or exchange shall be treated as gain
23 described in subsection (a) to the extent attrib-
24 utable to unrealized small business stock gain.

1 “(B) UNREALIZED SMALL BUSINESS
2 STOCK GAIN.—For purposes of subparagraph
3 (A), the term ‘unrealized small business stock
4 gain’ means the amount which would be eligible
5 gain if the qualified small business stock held
6 by such company had been sold at the time of
7 the sale of the interest referred to in subpara-
8 graph (A).

9 “(C) CERTAIN RULES TO APPLY.—Rules
10 similar to the rules of paragraphs (2)(B) and
11 (3) of subsection (g) shall apply for purposes of
12 this subsection.

13 “(3) APPLICATION OF ACTIVE BUSINESS RE-
14 QUIREMENT TO STOCK HELD BY SPECIALIZED
15 SMALL BUSINESS INVESTMENT COMPANIES.—For
16 purposes of determining whether stock held by a
17 specialized small business investment company is
18 qualified small business stock, subsection (e) shall be
19 applied by treating as a qualified trade or business
20 any trade or business in which such company is per-
21 mitted to invest under the Small Business Invest-
22 ment Act of 1958.

23 “(4) SPECIALIZED SMALL BUSINESS INVEST-
24 MENT COMPANY.—For purposes of this subsection,

1 the term ‘specialized small business investment com-
2 pany’ means any partnership or corporation which—

3 “(A) as of September 30, 1996, is licensed
4 by the Small Business Administration under
5 section 301(d) of the Small Business Invest-
6 ment Act of 1958, or

7 “(B) holds a license from the Small Busi-
8 ness Administration, issued after such date, to
9 operate as a specialized small business invest-
10 ment company.”

11 (b) DEFINITION OF SPECIALIZED SMALL BUSINESS
12 INVESTMENT COMPANY FOR PURPOSES OF WAIVER OF
13 ACTIVE BUSINESS REQUIREMENT.—Subparagraph (B) of
14 section 1202(e)(2) of such Code is amended to read as
15 follows:

16 “(B) SPECIAL RULE FOR SPECIALIZED
17 SMALL BUSINESS INVESTMENT COMPANIES.—
18 Notwithstanding any provision of subsection
19 (e), a corporation shall be treated as meeting
20 the active business requirements of such sub-
21 section for any period during which such cor-
22 poration qualifies as a specialized small busi-
23 ness investment company (as defined in sub-
24 section (k)(4)).”

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years beginning after
3 December 31, 1996.

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