

105TH CONGRESS  
1ST SESSION

# S. 745

To amend the Internal Revenue Code of 1986 to modify the partial exclusion from gross income of gain on certain small business stock, to provide a rollover of capital gains on certain small business investments, and for other purposes.

---

## IN THE SENATE OF THE UNITED STATES

MAY 15, 1997

Mr. BUMPERS (for himself, Ms. LANDRIEU, Mr. CLELAND, Mr. KERRY, and Mr. DASCHLE) introduced the following bill; which was read twice and referred to the Committee on Finance

---

## A BILL

To amend the Internal Revenue Code of 1986 to modify the partial exclusion from gross income of gain on certain small business stock, to provide a rollover of capital gains on certain small business investments, 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 “Small Business Capital  
5 Gains Enhancement Act of 1997”.

## 1 SEC. 2. MODIFICATIONS TO EXCLUSION OF GAIN ON CER-

## 2 TAIN SMALL BUSINESS STOCK.

## 3 (a) INCREASED EXCLUSION.—

4 (1) IN GENERAL.—Subsection (a) of section  
5 1202 of the Internal Revenue Code of 1986 (relating  
6 to 50-percent exclusion for gain from certain small  
7 business stock) is amended—

8 (A) by striking “50 percent” and inserting  
9 “75 percent”, and

10 (B) by striking “50-PERCENT” in the  
11 heading and inserting “75-PERCENT”.

## 12 (2) CONFORMING AMENDMENTS.—

13 (A) The heading for section 1202 of such  
14 Code is amended by striking “**50-PERCENT**”  
15 and inserting “**75-PERCENT**”.

16 (B) The table of sections for part I of sub-  
17 chapter P of chapter 1 of such Code is amended  
18 by striking “50-percent” in the item relating to  
19 section 1202 and inserting “75-percent”.

## 20 (b) EXCLUSION AVAILABLE TO CORPORATIONS.—

21 (1) IN GENERAL.—Subsection (a) of section  
22 1202 of the Internal Revenue Code of 1986, as  
23 amended by subsection (a), is amended by striking  
24 “other than a corporation”.

4                   “(4) STOCK HELD AMONG MEMBERS OF CON-  
5                   TROLLED GROUP NOT ELIGIBLE.—Stock shall not be  
6                   treated as qualified small business stock if such  
7                   stock was at any time held by any member of the  
8                   parent-subsidiary controlled group (as defined in  
9                   subsection (d)(3)) which includes the qualified small  
10                  business.”

11 (c) REPEAL OF MINIMUM TAX PREFERENCE.—

12 (1) IN GENERAL.—Section 57(a) of the Internal  
13 Revenue Code of 1986 (relating to items of tax pref-  
14 erence) is amended by striking paragraph (7).

15 (2) TECHNICAL AMENDMENT.—Section  
16 53(d)(1)(B)(ii)(II) of such Code is amended by  
17 striking “, (5), and (7)” and inserting “and (5)”,

18 (d) STOCK OF LARGER BUSINESSES ELIGIBLE FOR  
19 EXCLUSION.—

20 (1) Section 1202(d)(1) of the Internal Revenue  
21 Code of 1986 (relating to qualified small business)  
22 is amended by striking “\$50,000,000” each place it  
23 appears and inserting “\$100,000,000”.

1                   “(4) INFLATION ADJUSTMENT OF ASSET LIMITATION.—In the case of stock issued in any calendar  
2                   year after 1997, the \$100,000,000 amount contained in paragraph (1) shall be increased by an  
3                   amount equal to—

6                   “(A) such dollar amount, multiplied by  
7                   “(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar  
8                   year in which the taxable year begins, determined by substituting ‘calendar year 1996’ for  
9                   ‘calendar year 1992’ in subparagraph (B)  
10                   thereof.

13                   If any amount as adjusted under the preceding sentence is not a multiple of \$1,000,000, such amount  
14                   shall be rounded to the next lower multiple of  
15                   \$1,000,000.”

17                   (e) PER-ISSUER LIMITATION.—Section  
18 1202(b)(1)(A) of the Internal Revenue Code of 1986 (relating to per-issuer limitation on taxpayer’s gain) is  
19                   amended by striking “\$10,000,000” and inserting  
20                   “\$20,000,000”.

22                   (f) OTHER MODIFICATIONS.—

23                   (1) WORKING CAPITAL LIMITATION.—Section  
24 1202(e)(6) of the Internal Revenue Code of 1986  
25                   (relating to working capital) is amended by striking

1       “2 years” each place it appears and inserting “5  
2       years”.

7                     “(D) WAIVER WHERE BUSINESS PUR-  
8                     POSE.—A purchase of stock by the issuing cor-  
9                     poration shall be disregarded for purposes of  
10                    subparagraph (B) if the issuing corporation es-  
11                    tablishes that there was a business purpose for  
12                    such purchase and one of the principal purposes  
13                    of the purchase was not to avoid the limitation  
14                    of this section.”

15 (g) EFFECTIVE DATES.—

20 (2) SPECIAL RULE.—The amendments made by  
21 subsections (c), (e), and (f) shall apply to stock is-  
22 sued after August 10, 1993.

1 **SEC. 3. ROLLOVER OF CAPITAL GAINS ON CERTAIN SMALL**  
2 **BUSINESS INVESTMENTS.**

3 (a) IN GENERAL.—Part III of subchapter O of chapter  
4 1 of the Internal Revenue Code of 1986 (relating to  
5 common nontaxable exchanges) is amended by adding at  
6 the end the following new section:

7 **“SEC. 1045. ROLLOVER OF GAIN ON SMALL BUSINESS IN-**  
8 **VESTMENTS.**

9 “(a) NONRECOGNITION OF GAIN.—In the case of the  
10 sale of any eligible small business investment with respect  
11 to which the taxpayer elects the application of this section,  
12 gain from such sale shall be recognized only to the extent  
13 that the amount realized on such sale exceeds—

14 “(1) the cost of any other eligible small business  
15 investment purchased by the taxpayer during  
16 the 6-month period beginning on the date of such  
17 sale, reduced by

18 “(2) any portion of such cost previously taken  
19 into account under this section.

20 This section shall not apply to any gain which is treated  
21 as ordinary income for purposes of this subtitle.

22 “(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

24 “(1) PURCHASE.—The term ‘purchase’ has the  
25 meaning given such term by section 1043(b)(4).

1           “(2) ELIGIBLE SMALL BUSINESS INVEST-  
2       MENT.—Except as otherwise provided in this sec-  
3       tion, the term ‘eligible small business investment’  
4       means any stock in a domestic corporation, and any  
5       partnership interest in a domestic partnership,  
6       which is originally issued after December 31, 1996,  
7       if—

8           “(A) as of the date of issuance, such cor-  
9       poration or partnership is a qualified small  
10      business entity,

11           “(B) such stock or partnership interest is  
12       acquired by the taxpayer at its original issue  
13       (directly or through an underwriter)—

14           “(i) in exchange for money or other  
15       property (not including stock), or

16           “(ii) as compensation for services  
17       (other than services performed as an un-  
18       derwriter of such stock or partnership in-  
19       terest), and

20           “(C) the taxpayer has held such stock or  
21       interest at least 6 months as of the time of the  
22       sale described in subsection (a).

23       A rule similar to the rule of section 1202(c)(3) shall  
24       apply for purposes of this section.

1                 “(3) ACTIVE BUSINESS REQUIREMENT.—Stock  
2         in a corporation, and a partnership interest in a  
3         partnership, shall not be treated as an eligible small  
4         business investment unless, during substantially all  
5         of the taxpayer’s holding period for such stock or  
6         partnership interest, such corporation or partnership  
7         meets the active business requirements of subsection  
8         (c). A rule similar to the rule of section  
9         1202(c)(2)(B) shall apply for purposes of this sec-  
10         tion.

11                 “(4) QUALIFIED SMALL BUSINESS ENTITY.—

12                 “(A) IN GENERAL.—The term ‘qualified  
13         small business entity’ means any domestic cor-  
14         poration or partnership if—

15                 “(i) such entity (and any predecessor  
16         thereof) had aggregate gross assets (as de-  
17         fined in section 1202(d)(2)) of less than  
18         \$25,000,000 at all times before the issu-  
19         ance of the interest described in paragraph  
20         (2), and

21                 “(ii) the aggregate gross assets (as so  
22         defined) of the entity immediately after the  
23         issuance (determined by taking into ac-  
24         count amounts received in the issuance)  
25         are less than \$25,000,000.

1                     “(B) AGGREGATION RULES.—Rules similar  
2                     to the rules of section 1202(d)(3) shall apply  
3                     for purposes of this paragraph.

4                     “(c) ACTIVE BUSINESS REQUIREMENT.—

5                     “(1) IN GENERAL.—For purposes of subsection  
6                     (b)(3), the requirements of this subsection are met  
7                     by a qualified small business entity for any period  
8                     if—

9                     “(A) the entity is engaged in the active  
10                     conduct of a trade or business, and

11                     “(B) at least 80 percent (by value) of the  
12                     assets of such entity are used in the active con-  
13                     duct of a qualified trade or business (within the  
14                     meaning of section 1202(e)(3)).

15                     Such requirements shall not be treated as met for  
16                     any period if during such period the entity is de-  
17                     scribed in subparagraph (A), (B), (C), or (D) of sec-  
18                     tion 1202(e)(4).

19                     “(2) SPECIAL RULE FOR CERTAIN ACTIVI-  
20                     TIES.—For purposes of paragraph (1), if, in connec-  
21                     tion with any future trade or business, an entity is  
22                     engaged in—

23                     “(A) startup activities described in section  
24                     195(c)(1)(A),

1               “(B) activities resulting in the payment or  
2               incurring of expenditures which may be treated  
3               as research and experimental expenditures  
4               under section 174, or

5               “(C) activities with respect to in-house re-  
6               search expenses described in section 41(b)(4),  
7               such entity shall be treated with respect to such ac-  
8               tivities as engaged in (and assets used in such activi-  
9               ties shall be treated as used in) the active conduct  
10               of a trade or business. Any determination under this  
11               paragraph shall be made without regard to whether  
12               the entity has any gross income from such activities  
13               at the time of the determination.

14               “(3) CERTAIN RULES TO APPLY.—Rules similar  
15               to the rules of paragraphs (5), (6), (7), and (8) of  
16               section 1202(e) shall apply for purposes of this sub-  
17               section.

18               “(d) CERTAIN OTHER RULES TO APPLY.—Rules  
19               similar to the rules of subsections (f), (g), (h), and (j)  
20               of section 1202 shall apply for purposes of this section,  
21               except that a 6-month holding period shall be substituted  
22               for a 5-year holding period where applicable.

23               “(e) BASIS ADJUSTMENTS.—If gain from any sale is  
24               not recognized by reason of subsection (a), such gain shall  
25               be applied to reduce (in the order acquired) the basis for

1 determining gain or loss of any eligible small business in-  
2 vestment which is purchased by the taxpayer during the  
3 6-month period described in subsection (a).

4       “(f) STATUTE OF LIMITATIONS.—If any gain is real-  
5 ized by the taxpayer on the sale or exchange of any eligible  
6 small business investment and there is in effect an election  
7 under subsection (a) with respect to such gain, then—

8           “(1) the statutory period for the assessment of  
9 any deficiency with respect to such gain shall not ex-  
10 pire before the expiration of 3 years from the date  
11 the Secretary is notified by the taxpayer (in such  
12 manner as the Secretary may by regulations pre-  
13 scribe) of—

14           “(A) the taxpayer’s cost of purchasing  
15 other eligible small business investments which  
16 the taxpayer claims results in nonrecognition of  
17 any part of such gain,

18           “(B) the taxpayer’s intention not to pur-  
19 chase other eligible small business investments  
20 within the 6-month period described in sub-  
21 section (a), or

22           “(C) a failure to make such purchase with-  
23 in such 6-month period, and

24           “(2) such deficiency may be assessed before the  
25 expiration of such 3-year period notwithstanding the

1 provisions of any other law or rule of law which  
2 would otherwise prevent such assessment.

3       “(g) REGULATIONS.—The Secretary shall prescribe  
4 such regulations as may be appropriate to carry out the  
5 purposes of this section, including regulations to prevent  
6 the avoidance of the purposes of this section through  
7 splitups, shell corporations, partnerships, or otherwise and  
8 regulations to modify the application of section 1202 to  
9 the extent necessary to apply such section to a partnership  
10 rather than a corporation.”

11       (b) CONFORMING AMENDMENT.—Paragraph (23) of  
12 section 1016(a) of the Internal Revenue Code of 1986 is  
13 amended—

14           (1) by striking “or 1044” and inserting “,  
15 1044, or 1045”, and  
16           (2) by striking “or 1044(d)” and inserting “,  
17 1044(d), or 1045(e)”.

18       (c) CLERICAL AMENDMENT.—The table of sections  
19 for part III of subchapter O of chapter 1 of the Internal  
20 Revenue Code of 1986 is amended by adding at the end  
21 the following new item:

“Sec. 1045. Rollover of gain on small business investments.”

22       (d) EFFECTIVE DATE.—The amendments made by  
23 this section shall apply to taxable years ending after De-  
24 cember 31, 1996.

