

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”.

1 (2) TECHNICAL AMENDMENT.—Subsection (c)
 2 of section 1202 of such Code is amended by adding
 3 at the end the following new paragraph:

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”.

24 (2) Section 1202(d) of such Code is amended
 25 by adding at the end the following new paragraph:

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

6 “(A) such dollar amount, multiplied by

7 “(B) the cost-of-living adjustment deter-
 8 mined under section 1(f)(3) for the calendar
 9 year in which the taxable year begins, deter-
 10 mined by substituting ‘calendar year 1996’ for
 11 ‘calendar year 1992’ in subparagraph (B)
 12 thereof.

13 If any amount as adjusted under the preceding sen-
 14 tence is not a multiple of \$1,000,000, such amount
 15 shall be rounded to the next lower multiple of
 16 \$1,000,000.”

17 (e) PER-ISSUER LIMITATION.—Section
 18 1202(b)(1)(A) of the Internal Revenue Code of 1986 (re-
 19 lating to per-issuer limitation on taxpayer’s gain) is
 20 amended by striking “\$10,000,000” and inserting
 21 “\$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”.

3 (2) REDEMPTION RULES.—Section 1203(c)(3)
4 of such Code (relating to certain purchases by cor-
5 poration of its own stock) is amended by adding at
6 the end the following new subparagraph:

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.—

16 (1) IN GENERAL.—Except as provided in para-
17 graph (2), the amendments made by this section
18 shall apply to stock issued after the date of the en-
19 actment of this Act.

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 chap-
 4 ter 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 busi-
 15 ness 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 pur-
 23 poses 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.

