

106TH CONGRESS
1ST SESSION

S. 55

To amend the Internal Revenue Code of 1986 to limit the tax rate for certain small businesses, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 19, 1999

Mr. KYL (for himself and Mr. COVERDELL) 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 limit the tax rate for certain small businesses, 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 Invest-
5 ment and Growth Act”.

6 **SEC. 2. S CORPORATION TAX RATE.**

7 (a) IN GENERAL.—Section 1 of the Internal Revenue
8 Code of 1986 (relating to tax imposed) is amended by add-
9 ing at the end the following new subsection:

1 “(i) TAX RATE ON CERTAIN S CORPORATION IN-
2 COME.—

3 “(1) IN GENERAL.—Except as provided in para-
4 graph (4), if a taxpayer has taxable S corporation
5 income for any taxable year to which this subsection
6 applies, then the tax imposed by this section shall
7 not exceed the sum of—

8 “(A) a tax computed at the rates and in
9 the same manner as if this subsection had not
10 been enacted on the greater of—

11 “(i) taxable income reduced by quali-
12 fied taxable S corporation income, or

13 “(ii) the amount of taxable income
14 taxed at a rate below 36 percent, plus

15 “(B) a tax of 34 percent of qualified tax-
16 able S corporation income in excess of the tax-
17 able income that is subject to tax under sub-
18 paragraph (A).

19 “(2) TAXABLE S CORPORATION INCOME.—For
20 purposes of this subsection—

21 “(A) QUALIFIED TAXABLE S CORPORATION
22 INCOME.—The term ‘qualified taxable S cor-
23 poration income’ means taxable S corporation
24 income only to the extent such income does not
25 exceed \$5,000,000.

1 “(B) SPECIAL RULE FOR QUALIFIED PER-
2 SONAL SERVICE CORPORATION.—

3 “(i) IN GENERAL.—In the case of a
4 qualified personal service corporation, tax-
5 able S corporation income taken into ac-
6 count under subparagraph (A) may not ex-
7 ceed the excess of—

8 “(I) capital expenditures during
9 the taxable year and the 2 prior tax-
10 able years, over

11 “(II) the amount of capital ex-
12 penditures taken into account under
13 subclause (I) for 2 prior taxable
14 years.

15 “(ii) ORDERING RULE.—For purposes
16 of clause (i), capital expenditures shall be
17 used in the order in which such expendi-
18 tures are made, beginning with the earliest
19 year.

20 “(C) TAXABLE S CORPORATION INCOME.—

21 The term ‘taxable S corporation income’ means,
22 with respect to any taxable year, the taxable in-
23 come of the taxpayer for such year attributable
24 to the active conduct of any trade or business
25 of an eligible S corporation.

1 “(D) ELIGIBLE S CORPORATION.—The
 2 term ‘eligible S corporation’ means an S cor-
 3 poration, except that such term does not
 4 include—

5 “(i) a personal service corporation as
 6 defined in section 469(j)(2), other than a
 7 qualified personal service corporation, and

8 “(ii) a personal holding company (as
 9 defined in section 542).

10 “(E) QUALIFIED PERSONAL SERVICE COR-
 11 PORATION DEFINED.—The term ‘qualified per-
 12 sonal service corporation’ has the meaning
 13 given such term in section 448(d)(2).

14 “(3) QUALIFIED RETAINED EARNINGS AC-
 15 COUNT.—For purposes of this subsection—

16 “(A) IN GENERAL.—Each S corporation
 17 shall establish a qualified retained earnings ac-
 18 count which shall be—

19 “(i) increased each year by the por-
 20 tion of the taxable income of the S cor-
 21 poration that is attributable to the active
 22 conduct of a trade or business by the S
 23 corporation,

24 “(ii) decreased each year by the por-
 25 tion of the taxable loss of the S corpora-

1 tion that is attributable to such active con-
 2 duct of a trade or business, and

3 “(iii) decreased by qualified and non-
 4 qualified distributions from such S cor-
 5 poration to the shareholders thereof.

6 “(B) QUALIFIED DISTRIBUTIONS.—For
 7 purposes of subparagraph (A), a distribution
 8 from a qualified retained earnings account shall
 9 be treated as a qualified distribution if the
 10 distribution—

11 “(i) is made to the owners of the eligi-
 12 ble S corporation, and

13 “(ii) is made to enable the S corpora-
 14 tion shareholder to pay income taxes (Fed-
 15 eral, State, local) on the income of the eli-
 16 gible S corporation.

17 The Secretary is authorized to promulgate reg-
 18 ulations pursuant to this subparagraph to pro-
 19 vide rules to determine the extent to which dis-
 20 tributions by an S corporation are made to en-
 21 able the distributee to pay its income taxes, in-
 22 cluding regulations that establish a presumption
 23 that distributions are to enable the distributee
 24 to pay income taxes if such distributions do not

1 exceed 34 percent of qualified taxable S cor-
 2 poration income.

3 “(C) DISTRIBUTIONS AFTER TAXABLE
 4 YEAR.—For purposes of subparagraph (B), a
 5 distribution from a qualified retained earnings
 6 account within 75 days after the end of a tax-
 7 able year of the eligible S corporation may be
 8 treated as a distribution made on the last day
 9 of such taxable year.

10 “(4) ADDITIONAL TAX ON NONQUALIFIED DIS-
 11 TRIBUTIONS.—

12 “(A) IN GENERAL.—If—

13 “(i) a distribution other than a quali-
 14 fied distribution is made from a qualified
 15 retained earnings account, and

16 “(ii) such distribution is made from
 17 additions to the account for a taxable year
 18 with respect to which paragraph (1)(B) ap-
 19 plied to the taxpayer by reason of such ad-
 20 ditions,

21 then the tax imposed by this section for the tax-
 22 able year of the taxpayer with or within which
 23 the taxable year of the eligible S corporation in
 24 which the distribution was made ends shall be

1 increased by the amount determined under sub-
 2 paragraph (B).

3 “(B) AMOUNT OF ADDITIONAL TAX.—The
 4 amount of tax determined under this subpara-
 5 graph is an amount equal to the product of the
 6 taxpayer’s pro rata share of the distribution de-
 7 scribed in subparagraph (A)(i) and the number
 8 of percentage points (and fractions thereof) by
 9 which the highest rate of tax applicable to the
 10 taxpayer in effect under this section for the tax-
 11 payer’s taxable year exceeds 34 percent.

12 “(C) ORDER OF DISTRIBUTIONS.—For
 13 purposes of this paragraph, distributions shall
 14 be treated as having been made from the quali-
 15 fied retained earnings account on a last-in,
 16 first-out basis. Distributions in excess of the
 17 balance of the qualified retained earnings ac-
 18 count shall not reduce such account below zero.

19 “(5) YEARS TO WHICH SUBSECTION APPLIES.—
 20 This subsection shall apply to any taxable year if the
 21 highest rate of tax set forth in subsection (a), (b),
 22 (c), (d), or (e) (whichever applies) for the taxable
 23 year exceeds 34 percent.

24 “(6) REGULATIONS.—The Secretary shall pre-
 25 scribe such regulations as may be necessary or ap-

1 appropriate to carry out the purposes of this section,
2 including regulations preventing the characterization
3 of distributions for purposes of compensation or per-
4 sonal use as distributions of qualified retained earn-
5 ings.”

6 (b) **EFFECTIVE DATE.**—The amendment made by
7 subsection (a) shall apply to taxable years beginning after
8 December 31, 1997.

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