

106TH CONGRESS
1ST SESSION

S. 875

To amend the Internal Revenue Code of 1986 to expand S corporation eligibility for banks, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 26, 1999

Mr. ALLARD (for himself, Mr. GRAMM, Mr. BENNETT, Mr. SHELBY, Mr. ABRAHAM, Mr. HAGEL, Mr. ENZI, Mr. MACK, and Mr. GRAMS) 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 expand S corporation eligibility for banks, 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 and
5 Financial Institutions Tax Relief Act of 1999”.

6 **SEC. 2. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
7 **HOLDERS TO INCLUDE IRAS.**

8 (a) IN GENERAL.—Section 1361(c)(2)(A) of the In-
9 ternal Revenue Code of 1986 (relating to certain trusts

1 permitted as shareholders) is amended by inserting after
 2 clause (v) the following:

3 “(vi) A trust which constitutes an in-
 4 dividual retirement account under section
 5 408(a), including one designated as a Roth
 6 IRA under section 408A.”

7 (b) TREATMENT AS SHAREHOLDER.—Section
 8 1361(c)(2)(B) of the Internal Revenue Code of 1986 (re-
 9 lating to treatment as shareholders) is amended by adding
 10 at the end the following:

11 “(vi) In the case of a trust described
 12 in clause (vi) of subparagraph (A), the in-
 13 dividual for whose benefit the trust was
 14 created shall be treated as a shareholder.”

15 (c) SALE OF STOCK IN IRA RELATING TO S COR-
 16 PORATION ELECTION EXEMPT FROM PROHIBITED
 17 TRANSACTION RULES.—Section 4975(d) of the Internal
 18 Revenue Code of 1986 (relating to exemptions) is amend-
 19 ed by striking “or” at the end of paragraph (14), by strik-
 20 ing the period at the end of paragraph (15) and inserting
 21 “; or”, and by adding at the end the following:

22 “(16) a sale of stock held by a trust which con-
 23 stitutes an individual retirement account under sec-
 24 tion 408(a) to the individual for whose benefit such

1 account is established if such sale is pursuant to an
 2 election under section 1362(a).”

3 (d) EFFECTIVE DATE.—The amendments made by
 4 this section shall apply to taxable years beginning after
 5 December 31, 1999.

6 **SEC. 3. EXCLUSION OF INVESTMENT SECURITIES INCOME**
 7 **FROM PASSIVE INCOME TEST FOR BANK S**
 8 **CORPORATIONS.**

9 (a) IN GENERAL.—Section 1362(d)(3)(C) of the In-
 10 ternal Revenue Code of 1986 (defining passive investment
 11 income) is amended by adding at the end the following:

12 “(v) EXCEPTION FOR BANKS; ETC.—
 13 In the case of a bank (as defined in section
 14 581), a bank holding company (as defined
 15 in section 246A(c)(3)(B)(ii)), or a qualified
 16 subchapter S subsidiary bank, the term
 17 ‘passive investment income’ shall not
 18 include—

19 “(I) interest income earned by
 20 such bank, bank holding company, or
 21 qualified subchapter S subsidiary
 22 bank, or

23 “(II) dividends on assets required
 24 to be held by such bank, bank holding
 25 company, or qualified subchapter S

1 subsidiary bank to conduct a banking
 2 business, including stock in the Fed-
 3 eral Reserve Bank, the Federal Home
 4 Loan Bank, or the Federal Agricul-
 5 tural Mortgage Bank or participation
 6 certificates issued by a Federal Inter-
 7 mediate Credit Bank.”

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

11 **SEC. 4. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
 12 **HOLDERS TO 150.**

13 (a) IN GENERAL.—Section 1361(b)(1)(A) of the In-
 14 ternal Revenue Code of 1986 (defining small business cor-
 15 poration) is amended by striking “75” and inserting
 16 “150”.

17 (b) EFFECTIVE DATE.—The amendment made by
 18 this section shall apply to taxable years beginning after
 19 December 31, 1999.

20 **SEC. 5. TREATMENT OF QUALIFYING DIRECTOR SHARES.**

21 (a) IN GENERAL.—Section 1361 of the Internal Rev-
 22 enue Code of 1986 is amended by adding at the end the
 23 following:

24 “(f) TREATMENT OF QUALIFYING DIRECTOR
 25 SHARES.—

1 “(1) IN GENERAL.—For purposes of this
2 subchapter—

3 “(A) qualifying director shares shall not be
4 treated as a second class of stock, and

5 “(B) no person shall be treated as a share-
6 holder of the corporation by reason of holding
7 qualifying director shares.

8 “(2) QUALIFYING DIRECTOR SHARES DE-
9 FINED.—For purposes of this subsection, the term
10 ‘qualifying director shares’ means any shares of
11 stock in a bank (as defined in section 581) or in a
12 bank holding company registered as such with the
13 Federal Reserve System—

14 “(i) which are held by an individual
15 solely by reason of status as a director of
16 such bank or company or its controlled
17 subsidiary; and

18 “(ii) which are subject to an agree-
19 ment pursuant to which the holder is re-
20 quired to dispose of the shares of stock
21 upon termination of the holder’s status as
22 a director at the same price as the indi-
23 vidual acquired such shares of stock.

24 “(3) DISTRIBUTIONS.—A distribution (not in
25 part or full payment in exchange for stock) made by

1 the corporation with respect to qualifying director
 2 shares shall be includible as ordinary income of the
 3 holder and deductible to the corporation as an ex-
 4 pense in computing taxable income under section
 5 1363(b) in the year such distribution is received.”

6 (b) CONFORMING AMENDMENTS.—

7 (1) Section 1361(b)(1) of the Internal Revenue
 8 Code of 1986 is amended by inserting “, except as
 9 provided in subsection (f),” before “which does not”.

10 (2) Section 1366(a) of such Code is amended
 11 by adding at the end the following:

12 “(3) ALLOCATION WITH RESPECT TO QUALI-
 13 FYING DIRECTOR SHARES.—The holders of quali-
 14 fying director shares (as defined in section 1361(f))
 15 shall not, with respect to such shares of stock, be al-
 16 located any of the items described in paragraph
 17 (1).”

18 (3) Section 1373(a) of such Code is amended
 19 by striking “and” at the end of paragraph (1), by
 20 striking the period at the end of paragraph (2) and
 21 inserting “, and”, and adding at the end the fol-
 22 lowing:

23 “(3) no amount of an expense deductible under
 24 this subchapter by reason of section 1361(f)(3) shall
 25 be apportioned or allocated to such income.”

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

4 **SEC. 6. BAD DEBT CHARGE OFFS IN YEARS AFTER ELEC-**
 5 **TION YEAR TREATED AS ITEMS OF BUILT-IN**
 6 **LOSS.**

7 The Secretary of the Treasury shall modify Regula-
 8 tion 1.1374–4(f) for S corporation elections made in tax-
 9 able years beginning after December 31, 1996, with re-
 10 spect to bad debt deductions under section 166 of the In-
 11 ternal Revenue Code of 1986 to treat such deductions as
 12 built-in losses under section 1374(d)(4) of such Code dur-
 13 ing the entire period during which the bank recognizes
 14 built-in gains from changing its accounting method for
 15 recognizing bad debts from the reserve method under sec-
 16 tion 585 of such Code to the charge-off method under sec-
 17 tion 166 of such Code.

18 **SEC. 7. INCLUSION OF BANKS IN 3-YEAR S CORPORATION**
 19 **RULE FOR CORPORATE PREFERENCE ITEMS.**

20 (a) IN GENERAL.—Section 1363(b) of the Internal
 21 Revenue Code of 1986 (relating to computation of cor-
 22 poration's taxable income) is amended by adding at the
 23 end the following new flush sentence:

1 “Paragraph (4) shall apply to any bank whether such
 2 bank is an S corporation or a qualified subchapter S sub-
 3 sidiary.”

4 (b) EFFECTIVE DATE.—The amendment made by
 5 this section shall apply to taxable years beginning after
 6 December 31, 1999.

7 **SEC. 8. C CORPORATION RULES TO APPLY FOR FRINGE**
 8 **BENEFIT PURPOSES.**

9 (a) IN GENERAL.—Section 1372 of the Internal Rev-
 10 enue Code of 1986 (relating to partnership rules to apply
 11 for fringe benefit purposes) is repealed.

12 (b) PARTNERSHIP RULES TO APPLY FOR HEALTH
 13 INSURANCE COSTS OF CERTAIN S CORPORATION SHARE-
 14 HOLDERS.—Paragraph (5) of section 162(1) of the Inter-
 15 nal Revenue Code of 1986 is amended to read as follows:

16 “(5) TREATMENT OF CERTAIN S CORPORATION
 17 SHAREHOLDERS.—

18 “(A) IN GENERAL.—This subsection shall
 19 apply in the case of any 2-percent shareholder
 20 of an S corporation, except that—

21 “(i) for purposes of this subsection,
 22 such shareholder’s wages (as defined in
 23 section 3121) from the S corporation shall
 24 be treated as such shareholder’s earned in-

1 come (within the meaning of section
2 401(c)(1)), and

3 “(ii) there shall be such adjustments
4 in the application of this subsection as the
5 Secretary may by regulations prescribe.

6 “(B) 2-PERCENT SHAREHOLDER DE-
7 FINED.—For purposes of this paragraph, the
8 term ‘2-percent shareholder’ means any person
9 who owns (or is considered as owning within
10 the meaning of section 318) on any day during
11 the taxable year of the S corporation more than
12 2 percent of the outstanding stock of such cor-
13 poration or stock possessing more than 2 per-
14 cent of the total combined voting power of all
15 stock of such corporation.”

16 (c) CONFORMING AMENDMENT.—The table of sec-
17 tions for part III of subchapter S of chapter 1 of the Inter-
18 nal Revenue Code of 1986 is amended by striking the item
19 relating to section 1372.

20 (d) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years beginning after
22 December 31, 1999.

1 **SEC. 9. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
 2 **HOLDERS TO INCLUDE FAMILY LIMITED**
 3 **PARTNERSHIPS.**

4 (a) IN GENERAL.—Section 1361(b)(1)(B) of the In-
 5 ternal Revenue Code of 1986 (defining small business cor-
 6 poration) is amended—

7 (1) by striking “or an organization” and insert-
 8 ing “an organization”, and

9 (2) by inserting “, or a family partnership de-
 10 scribed in subsection (c)(8)” after “subsection
 11 (c)(6)”.

12 (b) FAMILY PARTNERSHIP.—Section 1361(c) of the
 13 Internal Revenue Code of 1986 (relating to special rules
 14 for applying subsection (b)), as amended by section 5, is
 15 amended by adding at the end the following:

16 “(8) FAMILY PARTNERSHIPS.—

17 “(A) IN GENERAL.—For purposes of sub-
 18 section (b)(1)(B), any partnership or limited li-
 19 ability company may be a shareholder in an S
 20 corporation if—

21 “(i) all partners or members are mem-
 22 bers of 1 family as determined under sec-
 23 tion 704(e)(3), and

24 “(ii) all of the partners or members
 25 would otherwise be eligible shareholders of
 26 an S corporation.

1 “(B) TREATMENT AS SHAREHOLDERS.—
 2 For purposes of subsection (b)(1)(A), in the
 3 case of a partnership or limited liability com-
 4 pany described in subparagraph (A), each part-
 5 ner or member shall be treated as a share-
 6 holder.”

7 (c) EFFECTIVE DATE.—The amendments made by
 8 this section shall apply to taxable years beginning after
 9 December 31, 1999.

10 **SEC. 10. ISSUANCE OF PREFERRED STOCK PERMITTED.**

11 (a) IN GENERAL.—Section 1361 of the Internal Rev-
 12 enue Code of 1986, as amended by section 5(a), is amend-
 13 ed by adding at the end the following:

14 “(g) TREATMENT OF QUALIFIED PREFERRED
 15 STOCK.—

16 “(1) IN GENERAL.—For purposes of this
 17 subchapter—

18 “(A) qualified preferred stock shall not be
 19 treated as a second class of stock, and

20 “(B) no person shall be treated as a share-
 21 holder of the corporation by reason of holding
 22 qualified preferred stock.

23 “(2) QUALIFIED PREFERRED STOCK DE-
 24 FINED.—For purposes of this subsection, the term
 25 ‘qualified preferred stock’ means stock which meets

1 the requirements of subparagraphs (A), (B), and (C)
2 of section 1504(a)(4). Stock shall not fail to be
3 treated as qualified preferred stock solely because it
4 is convertible into other stock.

5 “(3) DISTRIBUTIONS.—A distribution (not in
6 part or full payment in exchange for stock) made by
7 the corporation with respect to qualified preferred
8 stock shall be includible as ordinary income of the
9 holder and deductible to the corporation as an ex-
10 pense in computing taxable income under section
11 1363(b) in the year such distribution is received.”

12 (b) CONFORMING AMENDMENTS.—

13 (1) Section 1361(b)(1) of the Internal Revenue
14 Code of 1986, as amended by section 5(b)(1), is
15 amended by striking “subsection (f)” and inserting
16 “subsections (f) and (g)”.

17 (2) Section 1366(a) of such Code, as amended
18 by section 5(b)(2), is amended by adding at the end
19 the following:

20 “(4) ALLOCATION WITH RESPECT TO QUALI-
21 FIED PREFERRED STOCK.—The holders of qualified
22 preferred stock (as defined in section 1361(g)) shall
23 not, with respect to such stock, be allocated any of
24 the items described in paragraph (1).”

1 (3) Section 1373(a)(3) of such Code, as added
 2 by section 5(b)(3), is amended by inserting “or
 3 1361(g)(3)” after “section 1361(f)(3)”.

4 (c) EFFECTIVE DATE.—The amendments made by
 5 this section shall apply to taxable years beginning after
 6 December 31, 1999.

7 **SEC. 11. CONSENT TO ELECTIONS.**

8 (a) 90 PERCENT OF SHARES REQUIRED FOR CON-
 9 SENT TO ELECTION.—Section 1362(a)(2) of the Internal
 10 Revenue Code of 1986 (relating to all shareholders must
 11 consent to election) is amended—

12 (1) by striking “all persons who are share-
 13 holders in” and inserting “shareholders holding at
 14 least 90 percent of the shares of”, and

15 (2) by striking “ALL SHAREHOLDERS” in the
 16 heading and inserting “AT LEAST 90 PERCENT OF
 17 SHARES”.

18 (b) RULES FOR CONSENT.—Section 1362(a) of the
 19 Internal Revenue Code of 1986 (relating to election) is
 20 amended by adding at the end the following:

21 “(3) RULES FOR CONSENT.—For purposes of
 22 making any consent required under paragraph (2) or
 23 subsection (d)(1)(B)—

24 “(A) each joint owner of shares shall con-
 25 sent with respect to such shares,

1 “(B) the personal representative or other
2 fiduciary authorized to act on behalf of the es-
3 tate of a deceased individual shall consent for
4 the estate,

5 “(C) one parent, the custodian, the guard-
6 ian, or the conservator shall consent with re-
7 spect to shares owned by a minor or subject to
8 a custodianship, guardianship, conservatorship,
9 or similar arrangement,

10 “(D) the trustee of a trust shall consent
11 with respect to shares owned in trust,

12 “(E) the trustee of the estate of a bank-
13 rupt individual shall consent for shares owned
14 by a bankruptcy estate,

15 “(F) an authorized officer or the trustee of
16 an organization described in subsection (c)(6)
17 shall consent for the shares owned by such or-
18 ganization, and

19 “(G) in the case of a partnership or lim-
20 ited liability company described in subsection
21 (c)(8)—

22 “(i) all general partners shall consent
23 with respect to shares owned by such part-
24 nership,

1 “(ii) all managers shall consent with
 2 respect to shares owned by such company
 3 if management of such company is vested
 4 in 1 or more managers, and

5 “(iii) all members shall consent with
 6 respect to shares owned by such company
 7 if management of such company is vested
 8 in the members.”

9 (c) TREATMENT OF NONCONSENTING SHAREHOLDER
 10 STOCK.—

11 (1) IN GENERAL.—Section 1361 of the Internal
 12 Revenue Code of 1986, as amended by section 10(a),
 13 is amended by adding at the end the following:

14 “(h) TREATMENT OF NONCONSENTING SHARE-
 15 HOLDER STOCK.—

16 “(1) IN GENERAL.—For purposes of this
 17 subchapter—

18 “(A) nonconsenting shareholder stock shall
 19 not be treated as a second class of stock,

20 “(B) such stock shall be treated as C cor-
 21 poration stock, and

22 “(C) the shareholder’s pro rata share
 23 under section 1366(a)(1) with respect to such
 24 stock shall be subject to tax paid by the S cor-

1 poration at the highest rate of tax specified in
2 section 11(b).

3 “(2) NONCONSENTING SHAREHOLDER STOCK
4 DEFINED.—For purposes of this subsection, the
5 term ‘nonconsenting shareholder stock’ means stock
6 of an S corporation which is held by a shareholder
7 who did not consent to an election under section
8 1362(a) with respect to such S corporation.

9 “(3) DISTRIBUTIONS.—A distribution (not in
10 part or full payment in exchange for stock) made by
11 the corporation with respect to nonconsenting share-
12 holder stock shall be includible as ordinary income
13 of the holder and deductible to the corporation as an
14 expense in computing taxable income under section
15 1363(b) in the year such distribution is received.”

16 (2) CONFORMING AMENDMENT.—Section
17 1361(b)(1) of the Internal Revenue Code of 1986, as
18 amended by section 10(b)(1), is amended by striking
19 “subsections (f) and (g)” and inserting “subsections
20 (f), (g), and (h)”.

21 (d) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to elections made in taxable years
23 beginning after December 31, 1999.

1 **SEC. 12. INFORMATION RETURNS FOR QUALIFIED SUB-**
2 **CHAPTER S SUBSIDIARIES.**

3 (a) **IN GENERAL.**—Section 1361(b)(3)(A) of the In-
4 ternal Revenue Code of 1986 (relating to treatment of cer-
5 tain wholly owned subsidiaries) is amended by inserting
6 “and in the case of information returns required under
7 part III of subchapter A of chapter 61” after “Secretary”.

8 (b) **EFFECTIVE DATE.**—The amendment made by
9 this section shall apply to taxable years beginning after
10 December 31, 1999.

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