

108TH CONGRESS  
2D SESSION

# H. R. 4796

To amend the Internal Revenue Code of 1986 to improve the operation of employee stock ownership plans, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JULY 9, 2004

Mr. BALLENGER (for himself, Mrs. JOHNSON of Connecticut, Mr. CANTOR, Mr. ROHRABACHER, Mr. GOODE, Mr. PAUL, and Mr. PLATTS) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to improve the operation of employee stock ownership plans, 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 “Employee Stock Own-  
5 ership Plan Promotion and Improvement Act of 2004”.

1 **SEC. 2. DISTRIBUTIONS BY AN S CORPORATION TO AN EM-**  
2 **PLOYEE STOCK OWNERSHIP PLAN.**

3 (a) IN GENERAL.—Section 1368 of the Internal Rev-  
4 enue Code of 1986 (relating to distributions) is amended  
5 by adding at the end the following new subsection:

6 “(f) DISTRIBUTIONS BY AN S CORPORATION TO AN  
7 EMPLOYEE STOCK OWNERSHIP PLAN.—Any distribution  
8 described in subsection (a) to an employee stock ownership  
9 plan (as defined in section 4975(e)(7)) shall be treated  
10 as a dividend under section 404(k)(2)(A).”.

11 (b) TECHNICAL AMENDMENT.—Section 404(a)(9)(C)  
12 of the Internal Revenue Code of 1986 (relating to S cor-  
13 porations) is amended to read as follows:

14 “(C) S CORPORATIONS.—The deduction  
15 provided in this paragraph shall not apply to an  
16 S corporation.”.

17 (c) EFFECTIVE DATE.—The amendments made by  
18 this section shall apply to distributions received after De-  
19 cember 31, 1998.

20 (d) WAIVER OF LIMITATIONS.—If refund or credit of  
21 any overpayment of tax resulting from the application of  
22 the amendments made by this section is prevented at any  
23 time before the close of the 1-year period beginning on  
24 the date of the enactment of this Act by the operation  
25 of any law or rule of law (including res judicata), such

1 refund or credit may nevertheless be made or allowed if  
 2 claim therefor is filed before the close of such period.

3 **SEC. 3. ESOP DIVIDEND EXCEPTION TO ADJUSTMENTS**  
 4 **BASED ON ADJUSTED CURRENT EARNINGS.**

5 (a) IN GENERAL.—Section 56(g)(4)(C) of the Inter-  
 6 nal Revenue Code of 1986 (relating to disallowance of  
 7 items not deductible in computing earnings and profits)  
 8 is amended by adding at the end the following new clause:

9 “(v) TREATMENT OF ESOP DIVI-  
 10 DENDS.—Clause (i) shall not apply to any  
 11 deduction allowable under section 404(k) if  
 12 the deduction is allowed for dividends paid  
 13 on employer securities held by an employee  
 14 stock ownership plan established or author-  
 15 ized to be established before March 15,  
 16 1991.”.

17 (b) EFFECTIVE DATE.—The amendment made by  
 18 this section shall apply to taxable years beginning after  
 19 December 31, 1989.

20 (c) WAIVER OF LIMITATIONS.—If refund or credit of  
 21 any overpayment of tax resulting from the application of  
 22 the amendment made by this section is prevented at any  
 23 time before the close of the 1-year period beginning on  
 24 the date of the enactment of this Act by the operation  
 25 of any law or rule of law (including res judicata), such

1 refund or credit may nevertheless be made or allowed if  
 2 claim therefor is filed before the close of such period.

3 **SEC. 4. AMENDMENTS RELATED TO SECTION 1042.**

4 (a) DEFERRAL OF TAX FOR CERTAIN SALES TO EM-  
 5 PLOYEE STOCK OWNERSHIP PLAN SPONSORED BY S COR-  
 6 PORATION.—

7 (1) IN GENERAL.—Section 1042(c)(1)(A) of the  
 8 Internal Revenue Code of 1986 (defining qualified  
 9 securities) is amended by striking “C”.

10 (2) EFFECTIVE DATE.—The amendment made  
 11 by paragraph (1) shall apply to sales after the date  
 12 of the enactment of this Act.

13 (b) REINVESTMENT IN CERTAIN MUTUAL FUNDS  
 14 PERMITTED.—

15 (1) IN GENERAL.—Clause (ii) of section  
 16 1042(c)(4)(B) of the Internal Revenue Code of 1986  
 17 (defining operating corporation) is amended to read  
 18 as follows:

19 “(ii) FINANCIAL INSTITUTIONS, IN-  
 20 SURANCE COMPANIES, AND MUTUAL  
 21 FUNDS.—The term ‘operating corporation’  
 22 shall include—

23 “(I) any financial institution de-  
 24 scribed in section 581,

1 “(II) any insurance company  
 2 subject to tax under subchapter L,  
 3 and

4 “(III) any regulated investment  
 5 company if substantially all of the se-  
 6 curities held by such company are se-  
 7 curities issued by operating corpora-  
 8 tions (determined without regard to  
 9 this subclause).”.

10 (2) EFFECTIVE DATE.—The amendment made  
 11 by paragraph (1) shall apply to sales of qualified se-  
 12 curities after the date of the enactment of this Act.

13 (c) MODIFICATION TO 25-PERCENT SHAREHOLDER  
 14 RULE.—

15 (1) IN GENERAL.—Subparagraph (B) of section  
 16 409(n)(1) of the Internal Revenue Code of 1986 (re-  
 17 lating to securities received in certain transactions)  
 18 is amended to read as follows:

19 “(B) for the benefit of any other person  
 20 who owns (after the application of section  
 21 318(a)) more than 25 percent of—

22 “(i) the total combined voting power  
 23 of all classes of stock of the corporation  
 24 which issued such employer securities or of  
 25 any corporation which is a member of the

1 same controlled group of corporations  
 2 (within the meaning of subsection (l)(4))  
 3 as such corporation, or

4 “(ii) the total value of all classes of  
 5 stock of any such corporation.”.

6 (2) EFFECTIVE DATE.—The amendment made  
 7 by paragraph (1) shall take effect on the date of the  
 8 enactment of this Act.

9 **SEC. 5. EARLY DISTRIBUTIONS FROM EMPLOYEE STOCK**  
 10 **OWNERSHIP PLANS FOR HIGHER EDUCATION**  
 11 **EXPENSES AND FIRST-TIME HOMEBUYER**  
 12 **PURCHASES.**

13 (a) IN GENERAL.—Paragraph (2) of section 72(t) of  
 14 the Internal Revenue Code of 1986 (relating to 10-percent  
 15 additional tax on early distributions from qualified retire-  
 16 ment plans) is amended by adding at the end the following  
 17 new subparagraph:

18 “(G) DISTRIBUTIONS FROM EMPLOYEE  
 19 STOCK OWNERSHIP PLANS FOR HIGHER EDU-  
 20 CATION EXPENSES AND FIRST-TIME HOME-  
 21 BUYER PURCHASES.—

22 “(i) IN GENERAL.—Distributions  
 23 made to the employee from an employee  
 24 stock ownership plan (within the meaning

of section 4975(e)(7)), the amount of which does not exceed the sum of—

“(I) qualified higher education expenses (as defined by paragraph (7)) reduced by the amount of such expenses taken into account under subparagraph (E), and

“(II) qualified first-time home-buyer distributions (as defined by paragraph (8)) reduced by the amount of such distributions taken into account under subparagraph (F).

“(ii) LIMITATION.—A distribution may only be taken into account under clause (i) if—

“(I) such distribution is in the form of either employer securities (within the meaning of section 409(l)) or cash proceeds resulting from the sale of such securities made not more than 180 days before the date of such distribution for the purposes of such distribution,

“(II) such securities so distributed or sold were held by such plan

1 for at least 5 years before the date of  
2 such distribution or, if applicable,  
3 sale, and

4 “(III) the number of shares in  
5 each class of such securities so dis-  
6 tributed or sold, when added to all  
7 previous distributions and sales of  
8 each such class of such securities for  
9 such purposes on behalf of such em-  
10 ployee, does not exceed 10 percent of  
11 the aggregate number of shares of  
12 each class of such securities allocated  
13 to the account of such employee under  
14 such plan.

15 “(iii) VALUATION OF DISTRIBUTED  
16 SECURITIES.—For purposes of clause (ii),  
17 the value of a security shall be the value  
18 of such security on the date of distribu-  
19 tion.”.

20 (b) CONFORMING AMENDMENTS.—

21 (1) Paragraph (7) of section 72(t) of such Code  
22 is amended by striking “paragraph (2)(E)” and in-  
23 serting “subparagraphs (E) and (G) of paragraph  
24 (2)”.



1           (2) Paragraph (8) of section 72(t) of such Code  
2       is amended by striking “paragraph (2)(F)” and in-  
3       serting “subparagraphs (F) and (G) of paragraph  
4       (2)”.

5       (c) EFFECTIVE DATE.—The amendments made by  
6       this section shall apply to distributions made after the  
7       date of the enactment of this Act.

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