

108TH CONGRESS
1ST SESSION

S. 850

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 10, 2003

Mr. ALLARD 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 2003”.

6 **SEC. 2. EXPANSION OF BANK S CORPORATION ELIGIBLE**
7 **SHAREHOLDERS 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 new clause:

3 “(vi) In the case of a corporation
 4 which is a bank (as defined in section
 5 581), a trust which constitutes an indi-
 6 vidual retirement account under section
 7 408(a), including one designated as a Roth
 8 IRA under section 408A, but only to the
 9 extent of the stock held by such trust in
 10 such bank as of the date of the enactment
 11 of this clause.”.

12 (b) TREATMENT AS SHAREHOLDER.—Section
 13 1361(c)(2)(B) of such Code (relating to treatment as
 14 shareholders) is amended by adding at the end the fol-
 15 lowing new clause:

16 “(vi) In the case of a trust described
 17 in clause (vi) of subparagraph (A), the in-
 18 dividual for whose benefit the trust was
 19 created shall be treated as a shareholder.”.

20 (c) SALE OF STOCK IN IRA RELATING TO S COR-
 21 PORATION ELECTION EXEMPT FROM PROHIBITED
 22 TRANSACTION RULES.—Section 4975(d) of such Code (re-
 23 lating to exemptions) is amended by striking “or” at the
 24 end of paragraph (14), by striking the period at the end

1 of paragraph (15) and inserting “; or”, and by adding at
 2 the end the following new paragraph:

3 “(16) a sale of stock held by a trust which con-
 4 stitutes an individual retirement account under sec-
 5 tion 408(a) to the individual for whose benefit such
 6 account is established if such sale is pursuant to an
 7 election under section 1362(a).”.

8 (d) CONFORMING AMENDMENT.—Section 512(e)(1)
 9 of such Code is amended by inserting “1361(c)(2)(A)(vi)
 10 or” before “1361(c)(6)”.

11 (e) EFFECTIVE DATE.—The amendments made by
 12 this section shall apply to trusts which constitute indi-
 13 vidual retirement accounts on the date of the enactment
 14 of this Act.

15 **SEC. 3. EXCLUSION OF INVESTMENT SECURITIES INCOME**
 16 **FROM PASSIVE INCOME TEST FOR BANK S**
 17 **CORPORATIONS.**

18 (a) IN GENERAL.—Section 1362(d)(3)(C) of the In-
 19 ternal Revenue Code of 1986 (defining passive invest-
 20 ment income) is amended by adding at the end the fol-
 21 lowing:

22 “(v) EXCEPTION FOR BANKS; ETC.—
 23 In the case of a bank (as defined in section
 24 581) or a bank holding company (as de-
 25 fined in section 246A(c)(3)(B)(ii)), the

1 term ‘passive investment income’ shall not
 2 include—

3 “(I) interest income earned by
 4 such bank or bank holding company,
 5 or

6 “(II) dividends on assets required
 7 to be held by such bank or bank hold-
 8 ing company to conduct a banking
 9 business, including stock in the Fed-
 10 eral Reserve Bank, the Federal Home
 11 Loan Bank, or the Federal Agricul-
 12 tural Mortgage Bank or participation
 13 certificates issued by a Federal Inter-
 14 mediate Credit Bank.”

15 (b) EFFECTIVE DATE.—The amendment made by
 16 this section shall apply to taxable years beginning after
 17 December 31, 2003.

18 **SEC. 4. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
 19 **HOLDERS TO 150.**

20 (a) IN GENERAL.—Section 1361(b)(1)(A) of the In-
 21 ternal Revenue Code of 1986 (defining small business cor-
 22 poration) is amended by striking “75 shareholders” and
 23 inserting “150 shareholders”.

1 (b) EFFECTIVE DATE.—The amendment made by
 2 this section shall apply to taxable years beginning after
 3 December 31, 2003.

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

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

8 “(f) TREATMENT OF QUALIFYING DIRECTOR
 9 SHARES.—

10 “(1) IN GENERAL.—For purposes of this sub-
 11 chapter—

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

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

17 “(2) QUALIFYING DIRECTOR SHARES DE-
 18 FINED.—For purposes of this subsection, the term
 19 ‘qualifying director shares’ means any shares of
 20 stock in a bank (as defined in section 581) or in a
 21 bank holding company registered as such with the
 22 Federal Reserve System—

23 “(i) which are held by an individual
 24 solely by reason of status as a director of

such bank or company or its controlled subsidiary; and

“(ii) which are subject to an agreement pursuant to which the holder is required to dispose of the shares of stock upon termination of the holder’s status as a director at the same price as the individual acquired such shares of stock.

“(3) DISTRIBUTIONS.—A distribution (not in part or full payment in exchange for stock) made by the corporation with respect to qualifying director shares shall be includible as ordinary income of the holder and deductible to the corporation as an expense in computing taxable income under section 1363(b) in the year such distribution is received.”

(b) CONFORMING AMENDMENTS.—

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

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

“(3) ALLOCATION WITH RESPECT TO QUALIFYING DIRECTOR SHARES.—The holders of qualifying director shares (as defined in section 1361(f)) shall not, with respect to such shares of stock, be al-

1 located any of the items described in paragraph
 2 (1).”

3 (c) EFFECTIVE DATE.—The amendments made by
 4 this section shall apply to taxable years beginning after
 5 December 31, 2003.

6 **SEC. 6. RECAPTURE OF BAD DEBT RESERVES.**

7 In the case of a bank which makes an S corporation
 8 election which first takes effect for a taxable year begin-
 9 ning after December 31, 2003, the entire adjustment re-
 10 quired by section 481 of the Internal Revenue Code of
 11 1986 by reason of changing its accounting method for rec-
 12 ognizing bad debts from the reserve method under section
 13 585 or 593 of such Code to the charge-off method under
 14 section 166 of such Code may be taken into in the year
 15 of the change or the preceding taxable year (whichever is
 16 elected by the bank).

17 **SEC. 7. CLARIFICATION OF 3-YEAR S CORPORATION RULE**
 18 **FOR CORPORATE PREFERENCE ITEMS.**

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

23 “Nothing in the preceding sentence shall be construed to
 24 apply section 291 to any taxable year which is more than

1 3 taxable years after the S corporation (or any prede-
 2 cessor) was a C corporation.”

3 (b) EFFECTIVE DATE.—The amendment made by
 4 this section shall apply to taxable years beginning after
 5 December 31, 2003.

6 **SEC. 8. MEMBERS OF FAMILY TREATED AS 1 SHARE-**
 7 **HOLDER.**

8 (a) IN GENERAL.—Paragraph (1) of section 1361(c)
 9 of the Internal Revenue Code of 1986 (relating to special
 10 rules for applying subsection (b)) is amended to read as
 11 follows:

12 “(1) MEMBERS OF FAMILY TREATED AS 1
 13 SHAREHOLDER.—

14 “(A) IN GENERAL.—For purpose of sub-
 15 section (b)(1)(A)—

16 “(i) except as provided in clause (ii),
 17 a husband and wife (and their estates)
 18 shall be treated as 1 shareholder, and

19 “(ii) in the case of a family with re-
 20 spect to which an election is in effect
 21 under subparagraph (E), all members of
 22 the family shall be treated as 1 share-
 23 holder.

24 “(B) MEMBERS OF THE FAMILY.—For
 25 purpose of subparagraph (A)(ii), the term

1 ‘members of the family’ means the common an-
 2 cestor, lineal descendants of the common ances-
 3 tor and the spouses (or former spouses) of such
 4 lineal descendants or common ancestor.

5 “(C) COMMON ANCESTOR.—For purposes
 6 of this paragraph, an individual shall not be
 7 considered a common ancestor if, as of the later
 8 of the effective date of this paragraph or the
 9 time the election under section 1362(a) is
 10 made, the individual is more than 3 generations
 11 removed from the youngest generation of share-
 12 holders.

13 “(D) EFFECT OF ADOPTION, ETC.—In de-
 14 termining whether any relationship specified in
 15 subparagraph (B) or (C) exists, the rules of
 16 section 152(b)(2) shall apply.

17 “(E) ELECTION.—An election under sub-
 18 paragraph (A)(ii)—

19 “(i) must be made with the consent of
 20 shareholders (including those that are fam-
 21 ily members) holding in the aggregate
 22 more than one-half of the shares of stock
 23 in the corporation on the day the election
 24 is made,

25 “(ii) in the case of—

1 “(I) an electing small business
2 trust, shall be made by the trustee of
3 the trust, and

4 “(II) a qualified subchapter S
5 trust, shall be made by the beneficiary
6 of the trust,

7 “(iii) under regulations, shall remain
8 in effect until terminated, and

9 “(iv) shall apply only with respect to
10 1 family in any corporation.”.

11 (b) RELIEF FROM INADVERTENT INVALID ELECTION
12 OR TERMINATION.—Section 1362(f) of such Code (relat-
13 ing to inadvertent invalid elections or terminations) is
14 amended—

15 (1) by inserting “or under section
16 1361(c)(1)(A)(ii)” after “subsection (a)” in para-
17 graph (1), and

18 (2) by inserting “or under section
19 1361(c)(1)(E)(iii)” after “subsection (d)” in para-
20 graph (1)(B).

21 (c) EFFECTIVE DATES.—

22 (1) SUBSECTION (a).—The amendment made
23 by subsection (a) shall apply to taxable years begin-
24 ning after December 31, 2003.

1 (2) SUBSECTION (b).—The amendments made
 2 by subsection (b) shall apply to elections and termi-
 3 nations made after December 31, 2003.

4 **SEC. 9. ISSUANCE OF PREFERRED STOCK PERMITTED.**

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

8 “(g) TREATMENT OF QUALIFIED PREFERRED
 9 STOCK.—

10 “(1) IN GENERAL.—For purposes of this sub-
 11 chapter—

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

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

17 “(2) QUALIFIED PREFERRED STOCK DE-
 18 FINED.—For purposes of this subsection, the term
 19 ‘qualified preferred stock’ means stock which meets
 20 the requirements of subparagraphs (A), (B), and (C)
 21 of section 1504(a)(4). Stock shall not fail to be
 22 treated as qualified preferred stock solely because it
 23 is convertible into other 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 qualified preferred
 2 stock 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, as amended by section 5(b)(1), is
 9 amended by striking “subsection (f)” and inserting
 10 “subsections (f) and (g)”.

11 (2) Section 1366(a) of such Code, as amended
 12 by section 5(b)(2), is amended by adding at the end
 13 the following:

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

19 (c) EFFECTIVE DATE.—The amendments made by
 20 this section shall apply to taxable years beginning after
 21 December 31, 2003.

22 **SEC. 10. INFORMATION RETURNS FOR QUALIFIED SUB-**
 23 **CHAPTER S SUBSIDIARIES.**

24 (a) IN GENERAL.—Section 1361(b)(3)(A) of the In-
 25 ternal Revenue Code of 1986 (relating to treatment of cer-

tain wholly owned subsidiaries) is amended by inserting
 “and in the case of information returns required under
 part III of subchapter A of chapter 61” after “Secretary”.

(b) EFFECTIVE DATE.—The amendment made by
 this section shall apply to taxable years beginning after
 December 31, 2003.

**SEC. 11. ADJUSTMENT TO BASIS OF S CORPORATION
 STOCK FOR CERTAIN CHARITABLE CON-
 TRIBUTIONS.**

(a) IN GENERAL.—Paragraph (2) of section 1367(a)
 of the Internal Revenue Code of 1986 (relating to adjust-
 ments to basis of stock of shareholders, etc.) is amended
 by adding at the end the following new flush sentence:

“The decrease under subparagraph (B) by reason of
 a charitable contribution (as defined in section
 170(c)) of property shall be the amount equal to the
 shareholder’s pro rata share of the adjusted basis of
 such property.”.

(b) EFFECTIVE DATE.—The amendment made by
 this section shall apply to taxable years beginning after
 December 31, 2003.

