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109TH CONGRESS
1ST SESSION

H. R. 1557

To amend the Internal Revenue Code of 1986 to provide an election for a special tax treatment of certain S corporation conversions.

IN THE HOUSE OF REPRESENTATIVES

APRIL 12, 2005

Mrs. CUBIN 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 provide an election for a special tax treatment of certain S corporation conversions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Small Business Tax Flexibility Act of 2005''.

SEC. 2. ELECTION FOR SPECIAL TAX TREATMENT OF CERTAIN S CORPORATION CONVERSIONS.

(a) IN GENERAL.—Part I of subchapter S of chapter 1 of the Internal Revenue Code of 1986 (relating to tax

treatment of S corporations and their shareholders) is amended by adding at the end the following new section:

"SEC. 1364. ELECTION FOR SPECIAL TAX TREATMENT OF CERTAIN S CORPORATION CONVERSIONS.

"(a) IN GENERAL.—A qualified electing S corporation may elect the special tax treatment provided in subsection (b) for an eligible corporate conversion in the manner set forth in subsection (f).

"(b) SPECIAL TAX TREATMENT.—

"(1) TRANSFERS TO PARTNERSHIP.—In the case of transfers by a qualified electing S corporation to a partnership in connection with an eligible corporate conversion, no gain or loss shall be recognized by shareholders of such corporation with respect to money or property received by the partnership.

"(2) OTHER TRANSFERS.—All other distributions of money or property by the qualified electing S corporation shall be treated as a distribution in part or full payment in exchange for the stock of such corporation.

"(c) QUALIFIED ELECTING S CORPORATION.—For purposes of this section, the term 'qualified electing S corporation' means a domestic corporation which—

"(1) has had a valid S election continuously in effect for the 10 taxable years of the corporation ending before the taxable year in which the election under this section is made, and

"(2) has never made an election under this section.

"(d) ELIGIBLE CORPORATE CONVERSION.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible corporate conversion' means (however affected)—

"(A) a transfer by a qualified electing S corporation of substantially all of its assets to a partnership (as defined in section 7701(a)(2)) for not less than 80 percent of the capital and profits of the partnership in any taxable year of the corporation ending on or before December 31, 2009,

"(B) the meeting of the requirement described in paragraph (2) by the partnership, and

"(C) the subsequent liquidation and dissolution of the qualified S corporation within the same taxable year as the transfer.

"(2) CONTINUITY OF BUSINESS REQUIREMENT.—

"(A) IN GENERAL.—The requirement described in this paragraph is met if the partnership described in paragraph (1)(A) either—

"(i) maintains the continuity of the qualified electing S corporation's business for 5 consecutive taxable years following the year in which the corporate conversion occurs, or

"(ii) pays a corporate conversion recapture tax in the taxable year in which the failure to maintain such continuity first occurs.

"(B) CONTINUITY OF THE QUALIFIED ELECTING S CORPORATION'S BUSINESS.—For purposes of subparagraph (A)(i), the term 'continuity of the qualified electing S corporation's business' means, under all the facts and circumstances, either—

"(i) the continuation of 1 or more of the S corporation's historic lines of business, or

"(ii) the use of a significant portion of the S corporation's historic business assets, whether or not such assets have a taxable

basis, in the conduct of an active trade or business.

"(C) CORPORATE CONVERSION RECAPTURE TAX.—For purposes of subparagraph (A)(ii), the term 'corporate conversion recapture tax' means—

"(i) a recomputation of the tax under this subtitle of the partnership and the partners as if—

"(I) a recomputation of the tax under this subtitle of the partnership and the partners as if

"(II) the stock of such S corporation was owned in the same manner as the capital of the partnership, and

"(III) the S corporation were dissolved and its assets distributed to its shareholders in complete liquidation on the last day of the taxable year, multiplied by

"(ii) a fraction—

"(I) the numerator of which is the excess (if any) of 5 over the number of complete taxable years in which the partnership maintains continuity

of the qualified electing S corporation's business, and

"(II) the denominator of which is 5.

"(e) BASIS RULES.—In the case of an eligible corporate conversion, property in the hands of the partnership shall have the same basis as in the hands of the qualified electing S corporation immediately prior to the eligible corporate conversion.

"(f) METHOD OF MAKING ELECTION.—In order to elect the special tax treatment provided in subsection (b) for an eligible corporate conversion, the qualified electing S corporation shall file a written election claiming such treatment with the timely-filed information return of the S corporation for the taxable year in which the eligible corporate conversion occurs.".

(b) CLERICAL AMENDMENT.—The table of sections for such part I is amended by adding at the end the following new item:

"Sec 1363. Election for special tax treatment of certain s corporation conversions.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

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