

109TH CONGRESS
1ST SESSION

H. R. 3111

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

IN THE HOUSE OF REPRESENTATIVES

JUNE 29, 2005

Mrs. JOHNSON of Connecticut (for herself, Mr. JEFFERSON, and Mr. McCRERY) introduced the following bill; which was referred to the Committee on Ways and Means

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 2005”.

1 **SEC. 2. 10 PERCENT PENALTY TAX NOT TO APPLY TO CER-**
 2 **TAIN S CORPORATION DISTRIBUTIONS MADE**
 3 **ON STOCK HELD BY EMPLOYEE STOCK OWN-**
 4 **ERSHIP PLAN.**

5 (a) IN GENERAL.—Clause (vi) of section 72(t)(2)(A)
 6 of the Internal Revenue Code of 1986 (relating to general
 7 rule that subsection not to apply to certain distributions)
 8 is amended by inserting before the comma at the end the
 9 following: “or any distribution (as described in section
 10 1368(a)) with respect to S corporation stock that con-
 11 stitutes qualifying employer securities (as defined by sec-
 12 tion 409(l)) to the extent that such distributions are paid
 13 to a participant in the manner described in clause (i) or
 14 (ii) of section 404(k)(2)(A)”.

15 (b) EFFECTIVE DATE.—The amendments made by
 16 this section shall apply to distributions made after the
 17 date of the enactment of this Act.

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

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

24 “(v) TREATMENT OF ESOP DIVI-
 25 DENDS.—Clause (i) shall not apply to any
 26 deduction allowable under section 404(k) if

1 the deduction is allowed for dividends paid
2 on employer securities held by an employee
3 stock ownership plan established or author-
4 ized to be established before March 15,
5 1991.”.

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

9 (c) WAIVER OF LIMITATIONS.—If refund or credit of
10 any overpayment of tax resulting from the application of
11 the amendment made by this section is prevented at any
12 time before the close of the 1-year period beginning on
13 the date of the enactment of this Act by the operation
14 of any law or rule of law (including res judicata), such
15 refund or credit may nevertheless be made or allowed if
16 claim therefor is filed before the close of such period.

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

18 (a) DEFERRAL OF TAX FOR CERTAIN SALES TO EM-
19 PLOYEE STOCK OWNERSHIP PLAN SPONSORED BY S COR-
20 PORATION.—

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

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

4 (b) REINVESTMENT IN CERTAIN MUTUAL FUNDS
 5 PERMITTED.—

6 (1) IN GENERAL.—Clause (ii) of section
 7 1042(c)(4)(B) of the Internal Revenue Code of 1986
 8 (defining operating corporation) is amended to read
 9 as follows:

10 “(ii) FINANCIAL INSTITUTIONS, IN-
 11 SURANCE COMPANIES, AND MUTUAL
 12 FUNDS.—The term ‘operating corporation’
 13 shall include—

14 “(I) any financial institution de-
 15 scribed in section 581,

16 “(II) any insurance company
 17 subject to tax under subchapter L,
 18 and

19 “(III) any regulated investment
 20 company if substantially all of the se-
 21 curities held by such company are se-
 22 curities issued by operating corpora-
 23 tions (determined without regard to
 24 this subclause).”.

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

4 (c) MODIFICATION TO 25-PERCENT SHAREHOLDER
5 RULE.—

6 (1) IN GENERAL.—Subparagraph (B) of section
7 409(n)(1) of the Internal Revenue Code of 1986 (re-
8 lating to securities received in certain transactions)
9 is amended to read as follows:

10 “(B) for the benefit of any other person
11 who owns (after the application of section
12 318(a)) more than 25 percent of—

13 “(i) the total combined voting power
14 of all classes of stock of the corporation
15 which issued such employer securities or of
16 any corporation which is a member of the
17 same controlled group of corporations
18 (within the meaning of subsection (l)(4))
19 as such corporation, or

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

22 (2) EFFECTIVE DATE.—The amendment made
23 by paragraph (1) shall take effect on the date of the
24 enactment of this Act.

1 **SEC. 5. EARLY DISTRIBUTIONS FROM EMPLOYEE STOCK**
 2 **OWNERSHIP PLANS FOR HIGHER EDUCATION**
 3 **EXPENSES AND FIRST-TIME HOMEBUYER**
 4 **PURCHASES.**

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

10 “(G) DISTRIBUTIONS FROM EMPLOYEE
 11 STOCK OWNERSHIP PLANS FOR HIGHER EDU-
 12 CATION EXPENSES AND FIRST-TIME HOME-
 13 BUYER PURCHASES.—

14 “(i) IN GENERAL.—Distributions
 15 made to the employee from an employee
 16 stock ownership plan (within the meaning
 17 of section 4975(e)(7)), the amount of
 18 which does not exceed the sum of—

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

24 “(II) qualified first-time home-
 25 buyer distributions (as defined by
 26 paragraph (8)) reduced by the amount

1 of such distributions taken into ac-
2 count under subparagraph (F).

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

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

14 “(II) such securities so distrib-
15 uted or sold were held by such plan
16 for at least 5 years before the date of
17 such distribution or, if applicable,
18 sale, and

19 “(III) the number of shares in
20 each class of such securities so dis-
21 tributed or sold, when added to all
22 previous distributions and sales of
23 each such class of such securities for
24 such purposes on behalf of such em-
25 ployee, does not exceed 10 percent of

1 the aggregate number of shares of
 2 each class of such securities allocated
 3 to the account of such employee under
 4 such plan.

5 “(iii) VALUATION OF DISTRIBUTED
 6 SECURITIES.—For purposes of clause (ii),
 7 the value of a security shall be the value
 8 of such security on the date of distribu-
 9 tion.”.

10 (b) CONFORMING AMENDMENTS.—

11 (1) Paragraph (7) of section 72(t) of such Code
 12 is amended by striking “paragraph (2)(E)” and in-
 13 serting “subparagraphs (E) and (G) of paragraph
 14 (2)”.

15 (2) Paragraph (8) of section 72(t) of such Code
 16 is amended by striking “paragraph (2)(F)” and in-
 17 serting “subparagraphs (F) and (G) of paragraph
 18 (2)”.

19 (c) EFFECTIVE DATE.—The amendments made by
 20 this section shall apply to distributions made after the
 21 date of the enactment of this Act.

22 **SEC. 6. DE MINIMIS EXCEPTION TO DIVERSIFICATION OF**
 23 **INVESTMENT REQUIREMENT.**

24 (a) IN GENERAL.—Paragraph (28) of section 401(a)
 25 of the Internal Revenue Code of 1986 (relating to addi-

1 tional requirements relating to employee stock ownership
2 plans) is amended by adding at the end the following new
3 subparagraph:

4 “(D) EXCEPTION FOR DE MINIMIS AC-
5 COUNT BALANCE.—A plan shall not fail to meet
6 the requirements of this subparagraph for a
7 plan year solely because the plan provides that
8 clause (i) does not apply to any participant’s
9 account in the plan which, as of the close of the
10 preceding plan year, has an account balance
11 which does not exceed \$2,500.”.

12 (b) EFFECTIVE DATE.—The amendment made by
13 this section shall apply to plan years beginning after the
14 date of the enactment of this Act.

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