

110TH CONGRESS  
1ST SESSION

# H. R. 4840

To amend the Internal Revenue Code of 1986 to provide for S corporation reform, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

DECEMBER 19, 2007

Mr. KIND (for himself, Mr. RAMSTAD, Mrs. JONES of Ohio, Mr. ENGLISH of Pennsylvania, Ms. SCHWARTZ, Mr. SAM JOHNSON of Texas, and Mr. KAGEN) 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 for S corporation reform, 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, REFERENCE.**

4       (a) SHORT TITLE.—This Act may be cited as the “S  
5       Corporation Modernization Act of 2007”.

6       (b) AMENDMENT OF 1986 CODE.—Except as other-  
7       wise expressly provided, whenever in this Act an amend-  
8       ment or repeal is expressed in terms of an amendment  
9       to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-  
2 sion of the Internal Revenue Code of 1986.

3 **SEC. 2. REDUCED RECOGNITION PERIOD FOR BUILT-IN**  
4 **GAINS.**

5 (a) IN GENERAL.—Paragraph (7) of section 1374(d)  
6 (relating to definitions and special rules) is amended as  
7 follows:

8 “(7) RECOGNITION PERIOD.—The term ‘rec-  
9 ognition period’ means the 7-year period beginning  
10 with the 1st day of the 1st taxable year for which  
11 the corporation was an S corporation. For purposes  
12 of applying this section to any amount includible in  
13 income by reason of distributions to shareholders  
14 pursuant to section 593(e), the preceding sentence  
15 shall be applied without regard to the duration of  
16 the recognition period in effect on the date of such  
17 distribution.”.

18 (b) EFFECTIVE DATE.—The amendment made by  
19 this section—

20 (1) shall apply for purposes of determining the  
21 recognition period with respect to 1st days referred  
22 to in section 1374(d)(7) of the Internal Revenue  
23 Code of 1986 occurring before, on, or after the date  
24 of the enactment of this Act, but

1           (2) shall not apply for purposes of determining  
 2           the tax imposed by section 1374 of such Code for  
 3           taxable years ending before such date.

4   **SEC. 3. EXPANSION OF QUALIFYING BENEFICIARIES OF AN**  
 5                           **ELECTING SMALL BUSINESS TRUST.**

6           (a) NO LOOK THROUGH FOR ELIGIBILITY PUR-  
 7   POSES.—Clause (v) of section 1361(c)(2)(B) (relating to  
 8   treatment as shareholders) is amended by adding at the  
 9   end the following new sentence: “This clause shall not  
 10   apply for purposes of subsection (b)(1)(C).”.

11          (b) EFFECTIVE DATE.—The amendment made by  
 12   this section shall take effect on the date of the enactment  
 13   of this Act.

14   **SEC. 4. REPEAL OF EXCESSIVE PASSIVE INVESTMENT IN-**  
 15                           **COME AS A TERMINATION EVENT.**

16          (a) IN GENERAL.—Section 1362(d) (relating to ter-  
 17   mination) is amended by striking paragraph (3).

18          (b) CONFORMING AMENDMENTS.—

19               (1) Section 1362(f)(1) is amended by striking  
 20               “or (3)”.

21               (2) Clause (i) of section 1042(c)(4)(A) is  
 22               amended by striking “section 1362(d)(3)(C)” and  
 23               inserting “section 1375(b)(3)”.

1 (c) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to taxable years beginning after  
3 December 31, 2007.

4 **SEC. 5. MODIFICATIONS TO PASSIVE INCOME RULES.**

5 (a) INCREASED LIMIT.—

6 (1) IN GENERAL.—Paragraph (2) of section  
7 1375(a) (relating to tax imposed when passive in-  
8 vestment income of corporation having accumulated  
9 earnings and profits exceeds 25 percent of gross re-  
10 cepts) is amended by striking “25 percent” and in-  
11 serting “60 percent”.

12 (2) CONFORMING AMENDMENTS.—

13 (A) Subparagraph (J) of section 26(b)(2)  
14 is amended by striking “25 percent” and insert-  
15 ing “60 percent”.

16 (B) Clause (i) of section 1375(b)(1)(A) is  
17 amended by striking “25 percent” and inserting  
18 “60 percent”.

19 (C) The heading for section 1375 is  
20 amended by striking “**25 PERCENT**” and in-  
21 serting “**60 PERCENT**”.

22 (D) The table of sections for part III of  
23 subchapter S of chapter 1 is amended by strik-  
24 ing “25 percent” in the item relating to section  
25 1375 and inserting “60 percent”.

1 (b) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to taxable years beginning after  
3 December 31, 2007.

4 **SEC. 6. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**  
5 **HOLDERS TO INCLUDE IRAS.**

6 (a) IN GENERAL.—Clause (vi) of section  
7 1361(c)(2)(A) (relating to certain trusts permitted as  
8 shareholders) is amended to read as follows:

9 “(vi) A trust which constitutes an in-  
10 dividual retirement account under section  
11 408(a), including one designated as a Roth  
12 IRA under section 408A.”.

13 (b) SALE OF STOCK IN IRA RELATING TO S COR-  
14 PORATION ELECTION EXEMPT FROM PROHIBITED  
15 TRANSACTION RULES.—Paragraph (16) of section  
16 4975(d) (relating to exemptions) is amended to read as  
17 follows:

18 “(16) a sale of stock held by a trust which con-  
19 stitutes an individual retirement account under sec-  
20 tion 408(a) to the individual for whose benefit such  
21 account is established if—

22 “(A) such sale is pursuant to an election  
23 under section 1362(a) by the issuer of such  
24 stock,

1           “(B) such sale is for fair market value at  
 2           the time of sale (as established by an inde-  
 3           pendent appraiser) and the terms of the sale  
 4           are otherwise at least as favorable to such trust  
 5           as the terms that would apply on a sale to an  
 6           unrelated party,

7           “(C) such trust does not pay any commis-  
 8           sions, costs, or other expenses in connection  
 9           with the sale, and

10           “(D) the stock is sold in a single trans-  
 11           action for cash not later than 120 days after  
 12           the S corporation election is made.”.

13       (c) EFFECTIVE DATE.—The amendments made by  
 14       this section shall take effect on the date of the enactment  
 15       of this Act.

16       **SEC. 7. ALLOWANCE OF DEDUCTION FOR CHARITABLE**  
 17                       **CONTRIBUTIONS FOR ELECTING SMALL BUSI-**  
 18                       **NESS TRUSTS.**

19       (a) IN GENERAL.—Section 641(c)(2)(C) (relating to  
 20       modifications) is amended by adding at the end the fol-  
 21       lowing new sentence: “The deduction for charitable con-  
 22       tributions allowed under clause (i) shall be determined  
 23       without regard to section 642(c), and the limitations im-  
 24       posed by section 170(b)(1) on the amount of the deduction

1 shall be applied to the electing small business trust as if  
2 it were an individual.”.

3 (b) **EFFECTIVE DATE.**—The amendment made by  
4 this section shall apply to taxable years beginning after  
5 the date of the enactment of this Act.

6 **SEC. 8. ENTITY NEUTRALITY STUDY.**

7 Not later than December 31, 2009, the Comptroller  
8 General of the United States shall conduct a study on enti-  
9 ty neutrality under the Internal Revenue Code of 1986  
10 and shall submit a report to the Committee on Ways and  
11 Means of the House of Representatives which—

12 (1) discusses the challenges to providing equal  
13 treatment between S corporations and limited liabil-  
14 ity companies under the Internal Revenue Code of  
15 1986,

16 (2) identifies the differences under the Internal  
17 Revenue Code of 1986 between the various pass-  
18 through entity rules, and

19 (3) discusses why entities would prefer one set  
20 of rules over another.

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