

111TH CONGRESS  
1ST SESSION

# S. 996

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

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IN THE SENATE OF THE UNITED STATES

MAY 7, 2009

Mrs. LINCOLN (for herself and Mr. HATCH) introduced the following bill;  
which was read twice and referred to the Committee on Finance

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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 2009”.

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 MADE PERMANENT.**

5 (a) IN GENERAL.—Paragraph (7) of section 1374(d)  
 6 (relating to definitions and special rules) is amended to  
 7 read as 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 January  
 24 1, 2009, 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. REPEAL OF EXCESSIVE PASSIVE INVESTMENT IN-**  
5 **COME AS A TERMINATION EVENT.**

6           (a) IN GENERAL.—Paragraph (3) of section 1362(d)  
7           (relating to termination) is amended by adding at the end  
8           the following new subparagraph:

9                       “(D)    TERMINATION.—This    paragraph  
10           shall not apply to taxable years beginning after  
11           December 31, 2008.”.

12          (b) EFFECTIVE DATE.—The amendment made by  
13          this section shall apply to taxable years beginning after  
14          December 31, 2008.

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

16          (a) INCREASED LIMIT.—

17               (1) IN GENERAL.—Paragraph (2) of section  
18               1375(a) (relating to tax imposed when passive in-  
19               vestment income of corporation having accumulated  
20               earnings and profits exceeds 25 percent of gross re-  
21               ceipts) is amended by striking “25 percent” and in-  
22               serting “60 percent”.

23               (2) CONFORMING AMENDMENTS.—

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

4 (B) Clause (i) of section 1375(b)(1)(A) is  
 5 amended by striking “25 percent” and inserting  
 6 “60 percent”.

7 (C) The heading for section 1375 is  
 8 amended by striking “**25 PERCENT**” and in-  
 9 serting “**60 PERCENT**”.

10 (D) The table of sections for part III of  
 11 subchapter S of chapter 1 is amended by strik-  
 12 ing “25 percent” in the item relating to section  
 13 1375 and inserting “60 percent”.

14 (b) EFFECTIVE DATE.—The amendments made by  
 15 this section shall apply to taxable years beginning after  
 16 December 31, 2008.

17 **SEC. 5. EXPANSION OF QUALIFYING BENEFICIARIES OF AN**  
 18 **ELECTING SMALL BUSINESS TRUST.**

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

24 (b) EFFECTIVE DATE.—The amendment made by  
 25 this section shall take effect on January 1, 2009.

1 **SEC. 6. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**  
 2 **HOLDERS TO INCLUDE IRAS.**

3 (a) IN GENERAL.—Clause (vi) of section  
 4 1361(c)(2)(A) (relating to certain trusts permitted as  
 5 shareholders) is amended to read as follows:

6 “(vi) A trust which constitutes an in-  
 7 dividual retirement account under section  
 8 408(a), including one designated as a Roth  
 9 IRA under section 408A.”.

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

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

19 “(A) such sale is pursuant to an election  
 20 under section 1362(a) by the issuer of such  
 21 stock,

22 “(B) such sale is for fair market value at  
 23 the time of sale (as established by an inde-  
 24 pendent appraiser) and the terms of the sale  
 25 are otherwise at least as favorable to such trust

1 as the terms that would apply on a sale to an  
 2 unrelated party,

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

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

9 (c) EFFECTIVE DATE.—The amendments made by  
 10 this section shall take effect on January 1, 2009.

11 **SEC. 7. ALLOWANCE OF DEDUCTION FOR CHARITABLE**  
 12 **CONTRIBUTIONS FOR ELECTING SMALL BUSI-**  
 13 **NESS TRUSTS.**

14 (a) IN GENERAL.—Section 641(c)(2)(C) (relating to  
 15 modifications) is amended by adding at the end the fol-  
 16 lowing new sentence: “The deduction for charitable con-  
 17 tributions allowed under clause (i) shall be determined  
 18 without regard to section 642(c), and the limitations im-  
 19 posed by section 170(b)(1) on the amount of the deduction  
 20 shall be applied to the electing small business trust as if  
 21 it were an individual.”.

22 (b) EFFECTIVE DATE.—The amendment made by  
 23 this section shall apply to taxable years beginning after  
 24 December 31, 2008.

1 **SEC. 8. PERMANENT RULE REGARDING BASIS ADJUST-**  
2 **MENT TO STOCK OF S CORPORATIONS MAK-**  
3 **ING CHARITABLE CONTRIBUTIONS OF PROP-**  
4 **ERTY.**

5 (a) **IN GENERAL.**—Section 1367(a)(2) (relating to  
6 decreases in basis) is amended by striking the last sen-  
7 tence.

8 (b) **EFFECTIVE DATE.**—The amendment made by  
9 this section shall apply to contributions made in taxable  
10 years beginning after December 31, 2008.

