

112TH CONGRESS
2D SESSION

H. R. 3840

To amend the Internal Revenue Code of 1986 and the Social Security Act to provide for employment tax treatment of professional service businesses.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 31, 2012

Mr. STARK (for himself, Mr. RANGEL, and Mr. CROWLEY) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 and the Social Security Act to provide for employment tax treatment of professional service businesses.

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 “Narrowing Exceptions
5 for Withholding Taxes Act of 2012”.

6 **SEC. 2. EMPLOYMENT TAX TREATMENT OF PROFESSIONAL**
7 **SERVICE BUSINESSES.**

8 (a) IN GENERAL.—Section 1402 of the Internal Rev-
9 enue Code of 1986 is amended by adding at the end the
10 following new subsection:

1 “(m) SPECIAL RULES FOR PROFESSIONAL SERVICE
2 BUSINESSES.—

3 “(1) SHAREHOLDERS PROVIDING SERVICES TO
4 DISQUALIFIED S CORPORATIONS.—

5 “(A) IN GENERAL.—In the case of any dis-
6 qualified S corporation, each shareholder of
7 such disqualified S corporation who provides
8 substantial services with respect to the profes-
9 sional service business referred to in subpara-
10 graph (C) shall take into account such share-
11 holder’s pro rata share of all items of income or
12 loss described in section 1366 which are attrib-
13 utable to such business in determining the
14 shareholder’s net earnings from self-employ-
15 ment.

16 “(B) TREATMENT OF FAMILY MEMBERS.—
17 Except as otherwise provided by the Secretary,
18 the shareholder’s pro rata share of items re-
19 ferred to in subparagraph (A) shall be increased
20 by the pro rata share of such items of each
21 member of such shareholder’s family (within
22 the meaning of section 318(a)(1)) who does not
23 provide substantial services with respect to such
24 professional service business.

1 “(C) DISQUALIFIED S CORPORATION.—For
2 purposes of this subsection, the term ‘disquali-
3 fied S corporation’ means—

4 “(i) any S corporation which is a
5 partner in a partnership which is engaged
6 in a professional service business if sub-
7 stantially all of the activities of such S cor-
8 poration are performed in connection with
9 such partnership, and

10 “(ii) any other S corporation which is
11 engaged in a professional service business
12 if the principal asset of such business is
13 the reputation and skill of 3 or fewer em-
14 ployees.

15 “(2) PARTNERS.—In the case of any partner-
16 ship which is engaged in a professional service busi-
17 ness, subsection (a)(13) shall not apply to any part-
18 ner who provides substantial services with respect to
19 such professional service business.

20 “(3) PROFESSIONAL SERVICE BUSINESS.—For
21 purposes of this subsection, the term ‘professional
22 service business’ means any trade or business if sub-
23 stantially all of the activities of such trade or busi-
24 ness involve providing services in the fields of health,
25 law, lobbying, engineering, architecture, accounting,

1 actuarial science, performing arts, consulting, ath-
2 letics, investment advice or management, or broker-
3 age services.

4 “(4) REGULATIONS.—The Secretary shall pre-
5 scribe such regulations as may be necessary or ap-
6 propriate to carry out the purposes of this sub-
7 section, including regulations which prevent the
8 avoidance of the purposes of this subsection through
9 tiered entities or otherwise.

10 “(5) CROSS REFERENCE.—For employment tax
11 treatment of wages paid to shareholders of S cor-
12 porations, see subtitle C.”.

13 (b) CONFORMING AMENDMENT.—Section 211 of the
14 Social Security Act is amended by adding at the end the
15 following new subsection:

16 “(1) SPECIAL RULES FOR PROFESSIONAL SERVICE
17 BUSINESSES.—

18 “(1) SHAREHOLDERS PROVIDING SERVICES TO
19 DISQUALIFIED S CORPORATIONS.—

20 “(A) IN GENERAL.—In the case of any dis-
21 qualified S corporation, each shareholder of
22 such disqualified S corporation who provides
23 substantial services with respect to the profes-
24 sional service business referred to in subpara-
25 graph (C) shall take into account such share-

holder's pro rata share of all items of income or loss described in section 1366 of the Internal Revenue Code of 1986 which are attributable to such business in determining the shareholder's net earnings from self-employment.

“(B) TREATMENT OF FAMILY MEMBERS.—

Except as otherwise provided by the Secretary of the Treasury, the shareholder's pro rata share of items referred to in subparagraph (A) shall be increased by the pro rata share of such items of each member of such shareholder's family (within the meaning of section 318(a)(1) of the Internal Revenue Code of 1986) who does not provide substantial services with respect to such professional service business.

“(C) DISQUALIFIED S CORPORATION.—For

purposes of this subsection, the term ‘disqualified S corporation’ means—

“(i) any S corporation which is a partner in a partnership which is engaged in a professional service business if substantially all of the activities of such S corporation are performed in connection with such partnership, and

1 “(ii) any other S corporation which is
2 engaged in a professional service business
3 if the principal asset of such business is
4 the reputation and skill of 3 or fewer em-
5 ployees.

6 “(2) PARTNERS.—In the case of any partner-
7 ship which is engaged in a professional service busi-
8 ness, subsection (a)(12) shall not apply to any part-
9 ner who provides substantial services with respect to
10 such professional service business.

11 “(3) PROFESSIONAL SERVICE BUSINESS.—For
12 purposes of this subsection, the term ‘professional
13 service business’ means any trade or business if sub-
14 stantially all of the activities of such trade or busi-
15 ness involve providing services in the fields of health,
16 law, lobbying, engineering, architecture, accounting,
17 actuarial science, performing arts, consulting, ath-
18 letics, investment advice or management, or broker-
19 age services.”.

20 “(c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years beginning after
22 December 31, 2011.

○