

116TH CONGRESS
1ST SESSION

S. 2156

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

IN THE SENATE OF THE UNITED STATES

JULY 18, 2019

Mr. THUNE (for himself, Mr. CARDIN, and Mr. ROBERTS) introduced the following bill; which was read twice and referred to the Committee on Finance

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 2019”.

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. MODIFICATIONS TO S CORPORATION PASSIVE IN-**
 4 **VESTMENT INCOME RULES.**

5 (a) INCREASED PERCENTAGE LIMIT.—Section
 6 1375(a)(2) is amended by striking “25 percent” and in-
 7 serting “60 percent”.

8 (b) REPEAL OF EXCESSIVE PASSIVE INCOME AS A
 9 TERMINATION EVENT.—Section 1362(d) is amended by
 10 striking paragraph (3).

11 (c) CONFORMING AMENDMENTS.—

12 (1) Section 1375(b) is amended by striking
 13 paragraphs (3) and (4) and inserting the following
 14 new paragraph:

15 “(3) PASSIVE INVESTMENT INCOME DE-
 16 FINED.—

17 “(A) IN GENERAL.—Except as otherwise
 18 provided in this paragraph, the term ‘passive
 19 investment income’ means gross receipts de-
 20 rived from royalties, rents, dividends, interest,
 21 and annuities.

22 “(B) EXCEPTION FOR INTEREST ON
 23 NOTES FROM SALES OF INVENTORY.—The term
 24 ‘passive investment income’ shall not include in-
 25 terest on any obligation acquired in the ordi-

1 nary course of the corporation's trade or busi-
2 ness from its sale of property described in sec-
3 tion 1221(a)(1).

4 “(C) TREATMENT OF CERTAIN LENDING
5 OR FINANCE COMPANIES.—If the S corporation
6 meets the requirements of section 542(c)(6) for
7 the taxable year, the term ‘passive investment
8 income’ shall not include gross receipts for the
9 taxable year which are derived directly from the
10 active and regular conduct of a lending or fi-
11 nance business (as defined in section
12 542(d)(1)).

13 “(D) TREATMENT OF CERTAIN DIVI-
14 DENDS.—If an S corporation holds stock in a
15 C corporation meeting the requirements of sec-
16 tion 1504(a)(2), the term ‘passive investment
17 income’ shall not include dividends from such C
18 corporation to the extent such dividends are at-
19 tributable to the earnings and profits of such C
20 corporation derived from the active conduct of
21 a trade or business.

22 “(E) EXCEPTION FOR BANKS, ETC.—In
23 the case of a bank (as defined in section 581)
24 or a depository institution holding company (as
25 defined in section 3(w)(1) of the Federal De-

posit Insurance Act (12 U.S.C. 1813(w)(1))),
the term ‘passive investment income’ shall not
include—

“(i) interest income earned by such
bank or company, or

“(ii) dividends on assets required to
be held by such bank or company, includ-
ing stock in the Federal Reserve Bank, the
Federal Home Loan Bank, or the Federal
Agricultural Mortgage Bank or participa-
tion certificates issued by a Federal Inter-
mediate Credit Bank.

“(F) GROSS RECEIPTS FROM THE SALES
OF CERTAIN ASSETS.—For purposes of this
paragraph—

“(i) CAPITAL ASSETS OTHER THAN
STOCK AND SECURITIES.—In the case of
dispositions of capital assets (other than
stock and securities), gross receipts from
such dispositions shall be taken into ac-
count only to the extent of capital gain net
income therefrom.

“(ii) STOCK AND SECURITIES.—In the
case of sales or exchanges of stock or secu-
rities, gross receipts shall be taken into ac-

1 count only to the extent of the gain there-
2 from.

3 “(G) COORDINATION WITH SECTION
4 1374.—The amount of passive investment in-
5 come shall be determined by not taking into ac-
6 count any recognized built-in gain or loss of the
7 S corporation for any taxable year in the rec-
8 ognition period. Terms used in the preceding
9 sentence shall have the same respective mean-
10 ings as when used in section 1374.”.

11 (2)(A) Section 26(b)(2)(J) is amended by strik-
12 ing “25 percent” and inserting “60 percent”.

13 (B) Section 1375(b)(1)(A)(i) is amended by
14 striking “25 percent” and inserting “60 percent”.

15 (C) The heading for section 1375 is amended
16 by striking “**25 PERCENT**” and inserting “**60 PER-**
17 **CENT**”.

18 (D) The item relating to section 1375 in the
19 table of sections for part III of subchapter S of
20 chapter 1 is amended by striking “25 percent” and
21 inserting “60 percent”.

22 (3) Section 1042(c)(4)(A)(i) is amended by
23 striking “section 1362(d)(3)(C)” and inserting “sec-
24 tion 1375(b)(3)”.

1 (4) Section 1362(f)(1)(B) is amended by strik-
 2 ing “paragraph (2) or (3) of subsection (d)” and in-
 3 serting “subsection (d)(2)”.

4 (d) **EFFECTIVE DATE.**—The amendments made by
 5 this section shall apply to taxable years beginning after
 6 December 31, 2019.

7 **SEC. 3. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
 8 **HOLDERS TO INCLUDE IRAS.**

9 (a) **IN GENERAL.**—Section 1361(c)(2)(A)(vi) is
 10 amended to read as follows:

11 “(vi) A trust which constitutes an in-
 12 dividual retirement account under section
 13 408(a), including one designated as a Roth
 14 IRA under section 408A.”.

15 (b) **SALE OF STOCK IN IRA RELATING TO S COR-**
 16 **PORATION ELECTION EXEMPT FROM PROHIBITED**
 17 **TRANSACTION RULES.**—Section 4975(d)(16) is amend-
 18 ed—

19 (1) by striking subparagraphs (A) and (B) and
 20 by redesignating subparagraphs (C), (D), (E), and
 21 (F) as subparagraphs (A), (B), (C), and (D), respec-
 22 tively, and

23 (2) by striking “such bank or company” in sub-
 24 paragraph (A) (as so redesignated) and inserting
 25 “the issuer of such stock”.

1 (c) EFFECTIVE DATE.—The amendments made by
 2 this section shall take effect on January 1, 2020.

3 **SEC. 4. TREATMENT OF S CORPORATION BUILT-IN GAIN**
 4 **AMOUNT UPON DEATH OF SHAREHOLDER.**

5 (a) IN GENERAL.—Part II of subchapter S of chapter
 6 1 is amended by adding at the end the following:

7 **“SEC. 1369. AMORTIZATION OF BUILT-IN GAIN AMOUNT**
 8 **UPON DEATH OF SHAREHOLDER.**

9 “(a) IN GENERAL.—A person holding stock in an
 10 electing S corporation the basis of which is determined
 11 under section 1014(a) (hereafter in this section referred
 12 to as the ‘shareholder’) shall be allowed a deduction with
 13 respect to the S corporation built-in gain amount. The
 14 amount of such deduction for any taxable year shall be
 15 determined by amortizing the S corporation built-in gain
 16 amount over the 15-year period beginning with the month
 17 which includes the applicable valuation date.

18 “(b) S CORPORATION BUILT-IN GAIN AMOUNT.—
 19 For purposes of this section, the term ‘S corporation built-
 20 in gain amount’ means the lesser of—

21 “(1) the excess (if any) of—

22 “(A) the basis of the stock referred to in
 23 subsection (a) as determined under section
 24 1014(a), over

1 “(B) the adjusted basis of such stock im-
 2 mediately before the death of the decedent, or

3 “(2) the pro rata share (determined as of the
 4 applicable valuation date) of—

5 “(A) the aggregate fair market value of all
 6 property held by the S corporation which is of
 7 a character subject to depreciation or amortiza-
 8 tion, over

9 “(B) the aggregate adjusted basis of all
 10 such property held by the S corporation as of
 11 such date.

12 “(c) ELECTING S CORPORATION.—For purposes of
 13 this section, the term ‘electing S corporation’ means, with
 14 respect to any shareholder, any S corporation which elects
 15 the application of this section with respect to such share-
 16 holder at such time and in such form and manner as the
 17 Secretary may prescribe.

18 “(d) APPLICABLE VALUATION DATE.—For purposes
 19 of this section, the term ‘applicable valuation date’
 20 means—

21 “(1) in the case of a decedent with respect to
 22 which the executor of the decedent’s estate elects the
 23 application of section 2032, the date 6 months after
 24 the decedent’s death, and

1 “(2) in the case of any other decedent, the date
2 of the decedent’s death.

3 “(e) ACCELERATED DEDUCTION IN CASE OF DIS-
4 POSITION OF S CORPORATION PROPERTY.—

5 “(1) IN GENERAL.—If the electing S corpora-
6 tion disposes of any property which was taken into
7 account under subsection (b)(2), then the deduction
8 allowed under subsection (a) with respect to any
9 stock, for the taxable year of the shareholder in
10 which or with which the taxable year of the S cor-
11 poration which includes the date of such disposition
12 ends, shall (except as otherwise provided in this sec-
13 tion) not be less than the lesser of—

14 “(A) the pro rata share of the gain recog-
15 nized on such disposition, or

16 “(B) the amount determined under sub-
17 section (b)(2) by only taking into account such
18 property.

19 “(2) OVERALL ALLOWANCE NOT INCREASED.—
20 No deduction shall be allowed under subsection (a)
21 with respect to any stock for any taxable year to the
22 extent that such deduction (when added to the de-
23 ductions so allowed for all prior taxable years) ex-
24 ceeds the S corporation built-in gain amount with
25 respect to such stock.

1 “(f) RECHARACTERIZATION OF GAINS AS ORDINARY
2 INCOME TO EXTENT OF DEDUCTION.—If—

3 “(1) stock of an S corporation with respect to
4 which a deduction was allowed under this section, or
5 “(2) property which was taken into account
6 under subsection (b)(2) with respect to such stock,
7 is disposed of at a gain (determined without regard to
8 whether or not such gain is recognized and reduced by
9 any amount of gain which is treated as ordinary income
10 under any other provision of this subtitle), the amount of
11 such gain (or the shareholder’s pro rata share of such gain
12 in the case of property described in paragraph (2)) shall
13 be treated as gain which is ordinary income (and shall be
14 recognized notwithstanding any other provision of this
15 subtitle) to the extent of the excess of the aggregate de-
16 ductions allowable under this section with respect to such
17 stock for the taxable year of such disposition and all prior
18 taxable years over the amounts taken into account under
19 this subsection for all prior taxable years.

20 “(g) TERMINATION OF AMORTIZATION.—No deduc-
21 tion shall be allowed under subsection (a) with respect to
22 any stock in an electing S corporation with respect to any
23 period beginning after the earlier of—

24 “(1) the date on which the corporation’s elec-
25 tion under section 1362 terminates, or

1 “(2) the date on which the shareholder trans-
2 fers such stock to any other person.

3 “(h) TREATMENT OF CERTAIN TRANSFERS.—

4 “(1) DISTRIBUTIONS FROM ESTATES OR
5 TRUSTS.—Notwithstanding any other provision of
6 this section, in the case of a distribution of stock
7 from an estate or trust to a beneficiary, the bene-
8 ficiary (and not the estate or trust) shall be treated
9 as the shareholder to which this section applies with
10 respect to periods after such distribution.

11 “(2) CERTAIN TRANSFERS INVOLVING
12 SPOUSES.—Notwithstanding any other provision of
13 this section, in the case of a transfer described in
14 section 1041, the transferee (and not the transferor)
15 shall be treated as the shareholder to which this sec-
16 tion applies with respect to periods after such trans-
17 fer.

18 “(i) TREATMENT OF INCOME IN RESPECT OF THE
19 DECEDENT.—

20 “(1) ADJUSTMENT TO BUILT-IN GAIN OF PROP-
21 PERTY HELD BY S CORPORATION.—For purposes of
22 subsection (b)(2), the fair market value of any prop-
23 erty taken into account under subparagraph (A)
24 thereof shall be decreased by any amount of income
25 in respect of the decedent with respect to such prop-

erty to which section 691 applies. For purposes of subsection (e)(1)(A), the gain recognized on the disposition of such property shall be reduced by such amount.

“(2) ADJUSTMENT TO BASIS OF S CORPORATION STOCK.—For adjustment to basis of S corporation stock, see section 1367(b)(4)(B).

“(j) REPORTING.—Except as otherwise provided by the Secretary, for purposes of section 6037, the amounts determined under subsections (b)(2), (e)(1), and (f)(2) shall be treated as items of the corporation and the pro rata share determined under such subsection shall be furnished to the shareholder under section 6037(b).”.

(b) ADJUSTMENT TO BASIS OF STOCK.—

(1) IN GENERAL.—Section 1367(a)(2) is amended by striking “and” at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting “, and”, and by inserting after subparagraph (E) the following new subparagraph:

“(F) the amount of the shareholder’s deduction allowable under section 1369.”.

(2) ADJUSTMENT NOT TAKEN INTO ACCOUNT IN DETERMINING TREATMENT OF DISTRIBUTIONS.—Section 1368 is amended—

1 (A) in subsection (d)(1), by inserting
 2 “(other than subsection (a)(2)(F) thereof)”
 3 after “section 1367”, and

4 (B) in subsection (e)(1)(A)—

5 (i) by striking “this title and the
 6 phrase” and inserting “this title, the
 7 phrase”, and

8 (ii) by inserting “, and no adjustment
 9 shall be made under section
 10 1367(a)(2)(F)” after “section 1367(a)(2)”.

11 (c) CLERICAL AMENDMENT.—The table of sections
 12 for part II of subchapter S of chapter 1 is amended by
 13 adding at the end the following new item:

“Sec. 1369. Amortization of built-in gain amount upon death of shareholder.”.

14 (d) EFFECTIVE DATE.—The amendments made by
 15 this section shall apply with respect to decedents dying
 16 after the date of the enactment of this Act, in taxable
 17 years ending after such date.

18 **SEC. 5. REVOCATIONS OF S CORPORATION ELECTIONS.**

19 (a) REVOCATIONS.—Paragraph (1) of section
 20 1362(d) is amended—

21 (1) by striking “subparagraph (D)” in subpara-
 22 graph (C) and inserting “subparagraphs (D) and
 23 (E)”, and

24 (2) by adding at the end the following new sub-
 25 paragraph:

1 “(E) AUTHORITY TO TREAT LATE REVOCATIONS AS
2 TIMELY.—If—

3 “(i) a revocation under subparagraph
4 (A) is made for any taxable year after the
5 date prescribed by this paragraph for making
6 such revocation for such taxable year
7 or no such revocation is made for any taxable
8 year, and

9 “(ii) the Secretary determines that
10 there was reasonable cause for the failure
11 to timely make such revocation,
12 the Secretary may treat such a revocation as
13 timely made for such taxable year.”.

14 (b) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to revocations after December 31,
16 2019.

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