

103^D CONGRESS
2^D SESSION

H. R. 4175

To amend the Small Business Act to provide financial assistance to small businesses operating in urban empowerment zones and enterprise communities and to amend the Internal Revenue Code of 1986 to allow individuals an exclusion for capital gain from new investments in those small businesses.

IN THE HOUSE OF REPRESENTATIVES

APRIL 12, 1994

Mr. MACHTLEY introduced the following bill; which was referred jointly to the Committees on Small Business and Ways and Means

A BILL

To amend the Small Business Act to provide financial assistance to small businesses operating in urban empowerment zones and enterprise communities and to amend the Internal Revenue Code of 1986 to allow individuals an exclusion for capital gain from new investments in those small businesses.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

1 **SECTION 1. FINANCIAL ASSISTANCE FOR SMALL BUSI-**
2 **NESSES OPERATING IN URBAN**
3 **EMPOWERMENT ZONES AND ENTERPRISE**
4 **COMMUNITIES.**

5 Section 7(a) of the Small Business Act (15 U.S.C.
6 636(a)) is amended by adding at the end the following:

7 “(23)(A) Out of the amounts appropriated to
8 carry out this subsection, not less than
9 \$1,000,000,000 shall be expended in each fiscal year
10 for small business concerns operating in urban areas
11 designated as empowerment zones or enterprise com-
12 munities pursuant to section 1391 of the Internal
13 Revenue Code of 1986.

14 “(B) Subparagraph (A) shall apply to any fiscal
15 year beginning after September 30, 1994, in which
16 designations described in subparagraph (A) are in
17 effect.”.

18 **SEC. 2. EXCLUSION FOR CAPITAL GAIN FROM NEW INVEST-**
19 **MENTS IN SMALL BUSINESSES OPERATING IN**
20 **URBAN EMPOWERMENT ZONES AND ENTER-**
21 **PRISE COMMUNITIES.**

22 (a) IN GENERAL.—Subchapter U of chapter 1 of the
23 Internal Revenue Code of 1986 (relating to designation
24 and treatment of empowerment zones, enterprise commu-
25 nities, and rural development investment areas) is amend-

1 ed by redesignating part IV as part V and by inserting
2 after part III the following new part:

3 **“PART IV—EXCLUSION FOR CAPITAL GAIN FROM**
4 **NEW INVESTMENTS IN SMALL BUSINESSES**
5 **OPERATING IN URBAN EMPOWERMENT**
6 **ZONES AND ENTERPRISE COMMUNITIES**

“Sec. 1397D. Exclusion for gain from new investments in small
businesses operating in urban empowerment zones
and enterprise communities.

7 **“SEC. 1397D. EXCLUSION FOR GAIN FROM NEW INVEST-**
8 **MENTS IN SMALL BUSINESSES OPERATING IN**
9 **URBAN EMPOWERMENT ZONES AND ENTER-**
10 **PRISE COMMUNITIES.**

11 “(a) GENERAL RULE.—In the case of an individual,
12 gross income shall not include any qualified capital gain
13 recognized on the sale or exchange of a qualified zone
14 asset held for more than 5 years.

15 “(b) QUALIFIED ZONE ASSET.—For purposes of this
16 section:

17 “(1) IN GENERAL.—The term ‘qualified zone
18 asset’ means—

19 “(A) any qualified zone stock,

20 “(B) any qualified zone business property,

21 and

22 “(C) any qualified zone partnership inter-
23 est.

24 “(2) QUALIFIED ZONE STOCK.—

1 “(A) IN GENERAL.—Except as provided in
2 subparagraph (B), the term ‘qualified zone
3 stock’ means any stock in a domestic corpora-
4 tion if—

5 “(i) such stock is acquired by the tax-
6 payer on original issue from the corpora-
7 tion solely in exchange for cash,

8 “(ii) as of the time such stock was is-
9 sued, such corporation was a small urban
10 enterprise zone business (or, in the case of
11 a new corporation, such corporation was
12 being organized for purposes of being a
13 small urban enterprise zone business), and

14 “(iii) during substantially all of the
15 taxpayer’s holding period for such stock,
16 such corporation qualified as a small urban
17 enterprise zone business.

18 “(B) REDEMPTIONS.—The term ‘qualified
19 zone stock’ shall not include any stock acquired
20 from a corporation which made a substantial
21 stock redemption or distribution (without a
22 bona fide business purpose therefor) in an at-
23 tempt to avoid the purposes of this section.

1 “(3) QUALIFIED ZONE BUSINESS PROPERTY.—

2 The term ‘qualified zone business property’ means
3 tangible property if—

4 “(i) such property was acquired by
5 the taxpayer by purchase (as defined in
6 section 179(d)(2)) after the date on which
7 the designation of the urban tax enterprise
8 zone took effect,

9 “(ii) the original use of such property
10 in such an urban tax enterprise zone with
11 the taxpayer, and

12 “(iii) during substantially all of the
13 taxpayer’s holding period for such prop-
14 erty, substantially all of the use of such
15 property was in an urban tax enterprise
16 zone and in a small urban enterprise zone
17 business of the taxpayer.

18 “(A) SPECIAL RULE FOR SUBSTANTIAL IM-
19 PROVEMENTS.—The requirements of clauses (i)
20 and (ii) of subparagraph (A) shall be treated as
21 satisfied with respect to—

22 “(i) property which is substantially
23 improved by the taxpayer, and

24 “(ii) any land on which such property
25 is located.

1 For purposes of the preceding sentence, prop-
2 erty shall be treated as substantially improved
3 by the taxpayer if, during any 24-month period
4 beginning after the date on which the designa-
5 tion of the urban tax enterprise zone took ef-
6 fect, additions to basis with respect to such
7 property in the hands of the taxpayer exceed
8 the greater of (i) an amount equal to the ad-
9 justed basis at the beginning of such 24-month
10 period in the hands of the taxpayer, or (ii)
11 \$5,000.

12 “(B) LIMITATION ON LAND.—The term
13 ‘qualified zone business property’ shall not in-
14 clude land which is not an integral part of a
15 qualified business (as defined in section
16 1397B(d)).

17 “(4) QUALIFIED ZONE PARTNERSHIP INTER-
18 EST.—The term ‘qualified zone partnership interest’
19 means any interest in a partnership if—

20 “(A) such interest is acquired by the tax-
21 payer from the partnership solely in exchange
22 for cash,

23 “(B) as of the time such interest was ac-
24 quired, such partnership was a small urban en-
25 terprise zone business (or, in the case of a new

1 partnership, such partnership was being orga-
2 nized for purposes of being a small urban enter-
3 prise zone business), and

4 “(C) during substantially all of the tax-
5 payer’s holding period for such interest, such
6 partnership qualified as a small urban enter-
7 prise zone business.

8 A rule similar to the rule of paragraph (2)(C) shall
9 apply for purposes of this paragraph.

10 “(5) TREATMENT OF SUBSEQUENT PUR-
11 CHASERS.—The term ‘qualified zone asset’ includes
12 any property which would be a qualified zone asset
13 but for paragraph (2)(A)(i), (3)(A)(ii), or (4)(A) in
14 the hands of the taxpayer if such property was a
15 qualified zone asset in the hands of any prior holder.

16 “(6) 10-YEAR SAFE HARBOR.—If any property
17 ceases to be a qualified zone asset by reason of para-
18 graph (2)(A)(iii), (3)(A)(iii), or (4)(C) after the 10-
19 year period beginning on the date the taxpayer ac-
20 quired such property, such property shall continue to
21 be treated as meeting the requirements of such
22 paragraph; except that the amount of gain to which
23 subsection (a) applies on any sale or exchange of
24 such property shall not exceed the amount which

1 would be qualified capital gain had such property
2 been sold on the date of such cessation.

3 “(7) TREATMENT OF ZONE TERMINATIONS.—
4 The termination of any designation of an area as a
5 urban tax enterprise zone shall be disregarded for
6 purposes of determining whether any property is a
7 qualified zone asset.

8 “(c) SMALL URBAN ENTERPRISE ZONE BUSINESS;
9 URBAN TAX ENTERPRISE ZONE.—For purposes of this
10 section:

11 “(1) SMALL URBAN ENTERPRISE ZONE BUSI-
12 NESS.—The term ‘small urban enterprise zone busi-
13 ness’ means an enterprise zone business (as defined
14 in section 1397B) which normally employs 500 or
15 fewer employees on any day during the taxable year;
16 except that, in applying section 1397B for such pur-
17 poses—

18 “(A) references to empowerment zones
19 shall be treated as references only to urban tax
20 enterprise zones, and

21 “(B) the term ‘qualified business’ shall not
22 include any trade or business of producing
23 property of a character subject to the allowance
24 for depletion under section 611.

1 “(B) URBAN TAX ENTERPRISE ZONE.—The
2 term ‘urban tax enterprise zone’ means any
3 empowerment zone, and any enterprise community,
4 which is located in an urban area.

5 “(d) OTHER DEFINITIONS AND SPECIAL RULES.—
6 For purposes of this section:

7 “(1) QUALIFIED CAPITAL GAIN.—Except as
8 otherwise provided in this subsection, the term
9 ‘qualified capital gain’ means any long-term capital
10 gain.

11 “(2) CERTAIN GAIN ON REAL PROPERTY NOT
12 QUALIFIED.—The term ‘qualified capital gain’ shall
13 not include any gain which would be treated as ordi-
14 nary income under section 1250 if section 1250 ap-
15 plied to all depreciation rather than the additional
16 depreciation.

17 “(3) GAIN ATTRIBUTABLE TO PERIODS AFTER
18 TERMINATION OF ZONE DESIGNATION NOT QUALI-
19 FIED.—The term ‘qualified capital gain’ shall not in-
20 clude any gain attributable to periods after the ter-
21 mination of any designation of an area as an urban
22 tax enterprise zone.

23 “(e) TREATMENT OF PASS-THRU ENTITIES.—

24 “(1) SALES AND EXCHANGES.—Gain on the
25 sale or exchange of an interest in a pass-thru entity

1 held by the taxpayer (other than an interest in an
2 entity which was a small urban enterprise zone busi-
3 ness during substantially all of the period the tax-
4 payer held such interest) for more than 5 years shall
5 be treated as gain described in subsection (a) to the
6 extent such gain is attributable to amounts which
7 would be qualified capital gain on qualified zone as-
8 sets (determined as if such assets had been sold on
9 the date of the sale or exchange) held by such entity
10 for more than 5 years and throughout the period the
11 taxpayer held such interest. A rule similar to the
12 rule of paragraph (2)(C) shall apply for purposes of
13 the preceding sentence.

14 “(2) INCOME INCLUSIONS.—

15 “(A) IN GENERAL.—Any amount included
16 in income by reason of holding an interest in a
17 pass-thru entity (other than an entity which
18 was a small urban enterprise zone business dur-
19 ing substantially all of the period the taxpayer
20 held the interest to which such inclusion re-
21 lates) shall be treated as gain described in sub-
22 section (a) if such amount meets the require-
23 ments of subparagraph (B).

24 “(B) REQUIREMENTS.—An amount meets
25 the requirements of this subparagraph if—

1 “(i) such amount is attributable to
2 qualified capital gain recognized on the
3 sale or exchange by the pass-thru entity of
4 property which is a qualified zone asset in
5 the hands of such entity and which was
6 held by such entity for the period required
7 under subsection (a), and

8 “(ii) such amount is includible in the
9 gross income of the taxpayer by reason of
10 the holding of an interest in such entity
11 which was held by the taxpayer on the date
12 on which such pass-thru entity acquired
13 such asset and at all times thereafter be-
14 fore the disposition of such asset by such
15 pass-thru entity.

16 “(C) LIMITATION BASED ON INTEREST
17 ORIGINALLY HELD BY TAXPAYER.—Subpara-
18 graph (A) shall not apply to any amount to the
19 extent such amount exceeds the amount to
20 which subparagraph (A) would have applied if
21 such amount were determined by reference to
22 the interest the taxpayer held in the pass-thru
23 entity on the date the qualified zone asset was
24 acquired.

1 “(3) PASS-THRU ENTITY.—For purposes of this
2 subsection, the term ‘pass-thru entity’ means—

3 “(A) any partnership,

4 “(B) any S corporation,

5 “(C) any regulated investment company,

6 and

7 “(D) any common trust fund.

8 “(f) SALES AND EXCHANGES OF INTERESTS IN
9 PARTNERSHIPS AND S CORPORATIONS WHICH ARE
10 QUALIFIED ZONE BUSINESSES.—In the case of the sale
11 or exchange of an interest in a partnership, or of stock
12 in an S corporation, which was a small urban enterprise
13 zone business during substantially all of the period the
14 taxpayer held such interest or stock, the amount of quali-
15 fied capital gain shall be determined without regard to—

16 “(1) any intangible, and any land, which is not
17 an integral part of any qualified business (as defined
18 in section 1397B(d)), and

19 “(2) gain attributable to periods before the des-
20 ignation of an area as an urban tax enterprise zone.

21 “(g) CERTAIN TAX-FREE AND OTHER TRANS-
22 FERS.—For purposes of this section:

23 “(1) IN GENERAL.—In the case of a transfer of
24 a qualified zone asset to which this subsection ap-
25 plies, the transferee shall be treated as—

1 “(A) having acquired such asset in the
2 same manner as the transferor, and

3 “(B) having held such asset during any
4 continuous period immediately preceding the
5 transfer during which it was held (or treated as
6 held under this subsection) by the transferor.

7 “(2) TRANSFERS TO WHICH SUBSECTION AP-
8 PLIES.—This subsection shall apply to any trans-
9 fer—

10 “(A) by gift,

11 “(B) at death, or

12 “(C) from a partnership to a partner
13 thereof of a qualified zone asset with respect to
14 which the requirements of subsection (d)(2) are
15 met at the time of the transfer (without regard
16 to the 5-year holding requirement).

17 “(3) CERTAIN RULES MADE APPLICABLE.—
18 Rules similar to the rules of section 1244(d)(2) shall
19 apply for purposes of this section.”

20 (b) TECHNICAL AMENDMENTS.—

21 (1) Section 172(d)(2)(B) of such Code (relating
22 to modifications with respect to net operating loss
23 deduction) is amended to read as follows:

24 “(B) the exclusions provided by sections
25 1202 and 1397D shall not be allowed.”

1 (2) Paragraph (4) of section 642(c) of such
2 Code is amended—

3 (A) by inserting “or 1397D(a)” after “sec-
4 tion 1202(a)”, and

5 (B) by striking “section 1202” and insert-
6 ing “such section”.

7 (3) The last sentence of paragraph (3) of sec-
8 tion 643(a) of such Code is amended to read as fol-
9 lows: “The exclusions under sections 1202 and
10 1397D shall not be taken into account.”

11 (4) Paragraph (4) of section 691(c) of such
12 Code is amended by inserting “1397D,” after
13 “1201,”.

14 (5) The second sentence of paragraph (2) of
15 section 871(a) of such Code is amended by striking
16 “section 1202” and inserting “sections 1202 and
17 1397D”.

18 (6) The section 1397D of such Code contained
19 in part V of subchapter U of chapter 1 of such Code
20 (as redesignated by subsection (a)) is redesignated
21 as section 1397E.

22 (7) The table of parts for subchapter U of
23 chapter 1 of such Code is amended by striking the
24 last item and inserting the following:

“Part IV. Exclusion for capital gain from new investments in
small businesses operating in urban empowerment
zones and enterprise communities.

“Part V. Regulations.”

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall take effect on the date of the enactment
3 of this Act.

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