

103<sup>D</sup> CONGRESS  
2<sup>D</sup> SESSION

# H. R. 4877

To amend the Internal Revenue Code of 1986 to modify certain rules relating to subchapter S corporations.

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IN THE HOUSE OF REPRESENTATIVES

AUGUST 1, 1994

Mr. MCHALE 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 modify certain rules relating to subchapter S corporations.

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; AMENDMENT OF 1986 CODE.**

4 (a) SHORT TITLE.—This Act may be cited as the “S  
5 Corporation Investment Act of 1994”.

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. S CORPORATIONS PERMITTED TO HAVE 40 SHARE-**  
4 **HOLDERS.**

5 Subparagraph (A) of section 1361(b)(1) (defining  
6 small business corporation) is amended by striking “35  
7 shareholders” and inserting “40 shareholders”.

8 **SEC. 3. MEMBERS OF FAMILY TREATED AS 1 SHARE-**  
9 **HOLDER.**

10 Paragraph (1) of section 1361(c) (relating to special  
11 rules for applying subsection (b)) is amended to read as  
12 follows:

13 “(1) MEMBERS OF FAMILY TREATED AS 1  
14 SHAREHOLDER.—

15 “(A) IN GENERAL.—For purposes of sub-  
16 section (b)(1)(A)—

17 “(i) except as provided in clause (ii),  
18 a husband and wife (and their estates)  
19 shall be treated as 1 shareholder, and

20 “(ii) in the case of a family with re-  
21 spect to which an election is in effect  
22 under subparagraph (E), all members of  
23 the family shall be treated as 1 share-  
24 holder.

1           “(B) MEMBERS OF THE FAMILY.—For  
2 purposes of subparagraph (A)(ii), the term  
3 ‘members of the family’ means the lineal de-  
4 scendants of the common ancestor and the  
5 spouses (or former spouses) of such lineal de-  
6 scendants or common ancestor.

7           “(C) COMMON ANCESTOR.—For purposes  
8 of this paragraph, an individual shall not be  
9 considered a common ancestor if, as of the later  
10 of the effective date of this paragraph or the  
11 time the election under section 1362(a) is  
12 made, the individual is more than 4 generations  
13 removed from the youngest generation of share-  
14 holders.

15           “(D) EFFECT OF ADOPTION, ETC.—In de-  
16 termining whether any relationship specified in  
17 subparagraph (B) or (C) exists, the rules of  
18 section 152(b)(2) shall apply.

19           “(E) ELECTION.—An election under sub-  
20 paragraph (A)(ii)—

21                   “(i) must be made with the consent of  
22 all shareholders,

23                   “(ii) shall remain in effect until termi-  
24 nated, and

1 “(iii) shall apply only with respect to  
2 1 family in any corporation.”

3 **SEC. 4. INCREASE IN PASSIVE INCOME PERMITTED.**

4 (a) **TERMINATION PROVISION.**—Paragraph (3) of  
5 section 1362(d) (relating to termination) is amended by  
6 striking “25 percent” in the heading and in subparagraph  
7 (A)(i) and inserting “40 percent”.

8 (b) **TAX ON FORMER C CORPORATIONS.**—

9 (1) Subsections (a)(2) and (b)(1)(A)(i) of sec-  
10 tion 1375 (relating to tax imposed when passive in-  
11 vestment income of corporation having subchapter C  
12 earnings and profits exceeds 25 percent of gross re-  
13 cepts) are each amended by striking “25 percent”  
14 and inserting “40 percent”.

15 (2) The heading of section 1375 is amended by  
16 striking “**25 PERCENT**” and inserting “**40 PER-**  
17 **CENT**”.

18 (3) The table of sections for part III of sub-  
19 chapter S of chapter 1 is amended by striking “25  
20 percent” and inserting “40 percent” in the item re-  
21 lating to section 1375.

22 **SEC. 5. REINVESTMENT RESERVE.**

23 (a) **IN GENERAL.**—Part III of subchapter S of chap-  
24 ter 1 (relating to special rules) is amended by adding at  
25 the end the following new section:

1 **“SEC. 1376. REINVESTMENT RESERVE.**

2       “(a) IN GENERAL.—In the case of an S corporation,  
3 at the election of such corporation, there shall be allowed  
4 as a deduction for the taxable year an amount equal to  
5 the payments made by the corporation during such taxable  
6 year to a reinvestment reserve.

7       “(b) LIMITATION.—The amount which an S corpora-  
8 tion may pay into its reinvestment reserve for any taxable  
9 year shall not exceed an amount equal to 3 percent of its  
10 taxable income (determined without regard to this section)  
11 for such taxable year.

12       “(c) REINVESTMENT RESERVE.—

13               “(1) IN GENERAL.—Each S corporation which  
14 elects the application of this section shall establish  
15 a reinvestment reserve.

16               “(2) NO TAX ON RESERVE EARNINGS.—Earn-  
17 ings (including gains and losses) from the invest-  
18 ment of amounts in the reserve shall not be taken  
19 into account under this title.

20               “(3) USE OF RESERVE.—The reinvestment re-  
21 serve shall be used exclusively for the acquisition,  
22 construction, reconstruction, or erection of tangible  
23 property to which section 168 applies for use in the  
24 active conduct of a trade or business of the S cor-  
25 poration.

1           “(4) CONTRIBUTIONS TO RESERVE.—The rein-  
2           vestment reserve shall not accept any payments (or  
3           other amounts) other than payments with respect to  
4           which a deduction is allowable under subsection (a).

5           “(5) DISTRIBUTIONS FROM RESERVE.—There  
6           shall be includible in the gross income of the S cor-  
7           poration for any taxable year any amount distrib-  
8           uted from the reinvestment reserve during such tax-  
9           able year.

10           “(6) TREATMENT OF AMOUNTS NOT WITH-  
11           DRAWN WITHIN 3 YEARS.—

12                   “(A) IN GENERAL.—Any amount not with-  
13                   drawn from the reinvestment reserve within the  
14                   3-year period beginning on the date of its de-  
15                   posit shall be treated as distributed as of the  
16                   close of such period.

17                   “(B) DEEMED DISTRIBUTIONS TAXED AT  
18                   HIGHEST MARGINAL RATE.—If any amount is  
19                   treated under subparagraph (A) as distributed  
20                   during any taxable year—

21                           “(i) such amount shall be excluded  
22                           from the gross income of the corporation,  
23                           and

24                           “(ii) there is hereby imposed on such  
25                           amount a tax equal to the product of such

1 amount and the highest rate of tax speci-  
2 fied in section 1.

3 “(C) CERTAIN RULES TO APPLY.—Rules  
4 similar to the rules of subparagraphs (B) and  
5 (C) of paragraphs (5) and (6) of section  
6 7518(g) shall apply for purposes of this para-  
7 graph.

8 “(d) TIME WHEN PAYMENTS DEEMED MADE.—For  
9 purposes of this section, a taxpayer shall be deemed to  
10 have made a payment to the reinvestment reserve on the  
11 last day of a taxable year if such payment is made on  
12 account of such taxable year and is made with 2½ months  
13 after the close of such taxable year.”

14 (b) CLERICAL AMENDMENT.—The table of sections  
15 for part III of subchapter S of chapter 1 is amended by  
16 adding at the end the following new section:

“Sec. 1376. Reinvestment reserve.”

17 **SEC. 6. EFFECTIVE DATE.**

18 The amendments made by this Act shall apply to tax-  
19 able years beginning after the date of the enactment of  
20 this Act.

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