

106TH CONGRESS
1ST SESSION

H. R. 3082

To amend the Internal Revenue Code of 1986 to prohibit certain allocations of S corporation stock held by an employee stock ownership plan.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 14, 1999

Mr. RAMSTAD (for himself, Mr. CARDIN, Mr. CRANE, Mr. FOLEY, Mr. HERGER, Mr. HOUGHTON, Mrs. JOHNSON of Connecticut, Mr. KLECZKA, Mr. LEWIS of Kentucky, Mr. LUTHER, Mr. MCCRERY, Mr. MCINNIS, Mr. PORTMAN, Mrs. THURMAN, Mr. WATKINS, and Mr. WELLER) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to prohibit certain allocations of S corporation stock held by an employee stock ownership plan.

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. PROHIBITED ALLOCATIONS OF S CORPORA-**
4 **TIONS STOCK HELD BY AN ESOP.**

5 (a) IN GENERAL.—Section 409 of the Internal Rev-
6 enue Code of 1986 (relating to qualifications for tax credit
7 employee stock ownership plans) is amended by redesign-

1 nating subsection (p) as subsection (q) and by inserting
 2 after subsection (o) the following new subsection:

3 “(p) PROHIBITED ALLOCATIONS OF SECURITIES IN
 4 AN S CORPORATION.—

5 “(1) IN GENERAL.—An employee stock owner-
 6 ship plan holding employer securities consisting of
 7 stock in an S corporation shall provide that no por-
 8 tion of the assets of the plan attributable to (or allo-
 9 cable in lieu of) such employer securities may, dur-
 10 ing a nonallocation year, accrue (or be allocated di-
 11 rectly or indirectly under any plan of the employer
 12 meeting the requirements of section 401(a)) for the
 13 benefit of any disqualified person.

14 “(2) FAILURE TO MEET REQUIREMENTS.—

15 “(A) IN GENERAL.—If a plan fails to meet
 16 the requirements of paragraph (1), the plan
 17 shall be treated as having distributed to any
 18 disqualified person the amount allocated to the
 19 account of such person in violation of para-
 20 graph (1) at the time of such allocation.

21 “(B) CROSS REFERENCE.—

**“For excise tax relating to violations of paragraph
 (1) and ownership of synthetic equity, see section
 4979A.**

22 “(3) NONALLOCATION YEAR.—For purposes of
 23 this subsection—

1 “(A) IN GENERAL.—The term ‘nonalloca-
2 tion year’ means any plan year of an employee
3 stock ownership plan if, at any time during
4 such plan year—

5 “(i) such plan holds employer securi-
6 ties consisting of stock in an S corpora-
7 tion, and

8 “(ii) disqualified persons own at least
9 50 percent of the number of shares of
10 stock in the S corporation.

11 “(B) ATTRIBUTION RULES.—For purposes
12 of subparagraph (A)—

13 “(i) IN GENERAL.—The rules of sec-
14 tion 318(a) shall apply for purposes of de-
15 termining ownership, except that—

16 “(I) in applying paragraph (1)
17 thereof, the members of an individ-
18 ual’s family shall include members of
19 the family described in paragraph
20 (4)(D), and

21 “(II) paragraph (4) thereof shall
22 not apply.

23 “(ii) DEEMED-OWNED SHARES.—Not-
24 withstanding the employee trust exception
25 in section 318(a)(2)(B)(i), for purposes of

1 determining whether an individual is a dis-
2 qualified person, such individual shall be
3 treated as owning deemed-owned shares.

4 “(4) DISQUALIFIED PERSON.—For purposes of
5 this subsection—

6 “(A) IN GENERAL.—The term ‘disqualified
7 person’ means any person if—

8 “(i) the aggregate number of deemed-
9 owned shares of such person and the mem-
10 bers of such person’s family is at least 20
11 percent of the number of deemed-owned
12 shares of stock in the S corporation, or

13 “(ii) in the case of a person not de-
14 scribed in clause (i), the number of
15 deemed-owned shares of such person is at
16 least 10 percent of the number of deemed-
17 owned shares of stock in such corporation.

18 “(B) TREATMENT OF FAMILY MEMBERS.—
19 In the case of a disqualified person described in
20 subparagraph (A)(i), any member of such per-
21 son’s family with deemed-owned shares shall be
22 treated as a disqualified person if not otherwise
23 treated as a disqualified person under subpara-
24 graph (A).

1 “(C) DEEMED-OWNED SHARES.—For pur-
2 poses of this paragraph—

3 “(i) IN GENERAL.—The term
4 ‘deemed-owned shares’ means, with respect
5 to any person—

6 “(I) the stock in the S corpora-
7 tion constituting employer securities
8 of an employee stock ownership plan
9 which is allocated to such person
10 under the plan, and

11 “(II) such person’s share of the
12 stock in such corporation which is
13 held by such plan but which is not al-
14 located under the plan to participants.

15 “(ii) PERSON’S SHARE OF
16 UNALLOCATED STOCK.—For purposes of
17 clause (i)(II), a person’s share of
18 unallocated S corporation stock held by
19 such plan is the amount of the unallocated
20 stock which would be allocated to such per-
21 son if the unallocated stock were allocated
22 to all participants in the same proportions
23 as the most recent stock allocation under
24 the plan.

1 “(D) MEMBER OF FAMILY.—For purposes
2 of this paragraph, the term ‘member of the
3 family’ means, with respect to any individual—

4 “(i) the spouse of the individual,

5 “(ii) an ancestor or lineal descendant
6 of the individual or the individual’s spouse,

7 “(iii) a brother or sister of the indi-
8 vidual or the individual’s spouse and any
9 lineal descendant of the brother or sister,
10 and

11 “(iv) the spouse of any individual de-
12 scribed in clause (ii) or (iii).

13 A spouse of an individual who is legally sepa-
14 rated from such individual under a decree of di-
15 vorce or separate maintenance shall not be
16 treated as such individual’s spouse for purposes
17 of this subparagraph.

18 “(5) TREATMENT OF SYNTHETIC EQUITY.—For
19 purposes of paragraphs (3) and (4), in the case of
20 a person who owns synthetic equity in the S corpora-
21 tion, except to the extent provided in regulations, the
22 shares of stock in such corporation on which such
23 synthetic equity is based shall be treated as out-
24 standing stock in such corporation and deemed-
25 owned shares of such person if such treatment of

1 synthetic equity of 1 or more such persons results
2 in—

3 “(A) the treatment of any person as a dis-
4 qualified person, or

5 “(B) the treatment of any year as a non-
6 allocation year.

7 For purposes of this paragraph, synthetic equity
8 shall be treated as owned by a person in the same
9 manner as stock is treated as owned by a person
10 under the rules of paragraphs (2) and (3) of section
11 318(a).

12 “(6) DEFINITIONS.—For purposes of this
13 subsection—

14 “(A) EMPLOYEE STOCK OWNERSHIP
15 PLAN.—The term ‘employee stock ownership
16 plan’ has the meaning given such term by sec-
17 tion 4975(e)(7).

18 “(B) EMPLOYER SECURITIES.—The term
19 ‘employer security’ has the meaning given such
20 term by section 409(l).

21 “(C) SYNTHETIC EQUITY.—The term ‘syn-
22 thetic equity’ means any stock option, warrant,
23 restricted stock, deferred issuance stock right,
24 or similar interest or right that gives the holder
25 the right to acquire or receive stock of the S

corporation in the future. Except to the extent provided in regulations, synthetic equity also includes a stock appreciation right, phantom stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value.

“(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.”

(b) COORDINATION WITH SECTION 4975(e)(7).—The last sentence of section 4975(e)(7) of such Code (defining employee stock ownership plan) is amended by inserting “, section 409(p),” after “409(n)”.

(c) EXCISE TAX.—

(1) APPLICATION OF TAX.—Subsection (a) of section 4979A of such Code (relating to tax on certain prohibited allocations of employer securities) is amended—

(A) by striking “or” at the end of paragraph (1),

(B) by striking the period at the end of paragraph (2) and inserting a comma, and

(C) by striking all that follows paragraph (2) and inserting the following:

1 “(3) there is any allocation of employer securi-
 2 ties which violates the provisions of section 409(p),
 3 or

4 “(4) any synthetic equity is owned by a dis-
 5 qualified person in any nonallocation year,
 6 there is hereby imposed a tax on such allocation or owner-
 7 ship equal to 50 percent of the amount involved.”

8 (2) LIABILITY.—Section 4979A(c) of such Code
 9 (defining liability for tax) is amended to read as fol-
 10 lows:

11 “(c) LIABILITY FOR TAX.—The tax imposed by this
 12 section shall be paid—

13 “(1) in the case of an allocation referred to in
 14 paragraph (1) or (2) of subsection (a), by—

15 “(A) the employer sponsoring such plan, or

16 “(B) the eligible worker-owned cooperative,
 17 which made the written statement described in sec-
 18 tion 664(g)(1)(E) or in section 1042(b)(3)(B) (as
 19 the case may be), and

20 “(2) in the case of an allocation or ownership
 21 referred to in paragraph (3) or (4) of subsection (a),
 22 by the S corporation the stock in which was so allo-
 23 cated or owned.”

1 (3) DEFINITIONS.—Section 4979A(e) of such
2 Code (relating to definitions) is amended to read as
3 follows:

4 “(e) DEFINITIONS AND SPECIAL RULES.—For pur-
5 poses of this section—

6 “(1) DEFINITIONS.—Except as provided in
7 paragraph (2), terms used in this section have the
8 same respective meanings as when used in sections
9 409 and 4978.

10 “(2) SPECIAL RULES RELATING TO TAX IM-
11 POSED BY REASON OF PARAGRAPH (3) OR (4) OF
12 SUBSECTION (a).—

13 “(A) PROHIBITED ALLOCATIONS.—The
14 amount involved with respect to any tax im-
15 posed by reason of subsection (a)(3) is the
16 amount allocated to the account of any person
17 in violation of section 408(p)(1).

18 “(B) SYNTHETIC EQUITY.—The amount
19 involved with respect to any tax imposed by rea-
20 son of subsection (a)(4) is the value of the
21 shares on which the synthetic equity is based.

22 “(C) SPECIAL RULE FOR PROHIBITED AL-
23 LOCATION DURING FIRST NONALLOCATION
24 YEAR.—For purposes of subparagraph (A), the
25 amount involved for the first nonallocation year

1 of any employee stock ownership plan shall be
2 determined by taking into account the total
3 value of all the deemed-owned shares of all dis-
4 qualified persons with respect to such plan.

5 “(D) STATUTE OF LIMITATIONS.—The
6 statutory period for the assessment of any tax
7 imposed by this section by reason of paragraph
8 (3) or (4) of subsection (a) shall not expire be-
9 fore the date which is 3 years from the later
10 of—

11 “(i) the allocation or ownership re-
12 ferred to in such paragraph giving rise to
13 such tax, or

14 “(ii) the date on which the Secretary
15 is notified of such allocation or owner-
16 ship.”

17 (d) EFFECTIVE DATES.—

18 (1) IN GENERAL.—The amendments made by
19 this section shall apply to plan years beginning after
20 December 31, 2000.

21 (2) EXCEPTION FOR CERTAIN PLANS.—In the
22 case of any—

23 (A) employee stock ownership plan estab-
24 lished after July 14, 1999, or

1 (B) employee stock ownership plan estab-
2 lished on or before such date if employer securi-
3 ties held by the plan consist of stock in a cor-
4 poration with respect to which an election under
5 section 1362(a) of the Internal Revenue Code
6 of 1986 is not in effect on such date,
7 the amendments made by this section shall apply to
8 plan years ending after July 14, 1999.

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