

107TH CONGRESS
1ST SESSION

H. R. 1263

To amend the Internal Revenue Code of 1986 to expand S corporation eligibility for banks, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MARCH 28, 2001

Mr. MCINNIS (for himself, Mr. HEFLEY, Mr. TANCREDO, Mr. SCHAFFER, Mr. UDALL of Colorado, and Ms. DEGETTE) 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 expand S corporation eligibility for banks, 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.**

4 This Act may be cited as the “Small Business and
5 Financial Institutions Tax Relief Act of 2001”.

6 **SEC. 2. ELIGIBLE SHAREHOLDERS OF S CORPORATION**
7 **BANKS TO INCLUDE IRAS.**

8 (a) IN GENERAL.—Section 1361(c)(2)(A) of the In-
9 ternal Revenue Code of 1986 (relating to certain trusts

1 permitted as shareholders) is amended by inserting after
2 clause (v) the following:

3 “(vi) In the case of a corporation
4 which is a bank (as defined in section
5 581), a trust which constitutes an indi-
6 vidual retirement account under section
7 408(a), including one designated as a Roth
8 IRA under section 408A, but only to the
9 extent of the stock held in such bank as of
10 the date of the enactment of this clause.”

11 (b) TREATMENT AS SHAREHOLDER.—Section
12 1361(c)(2)(B) of the Internal Revenue Code of 1986 (re-
13 lating to treatment as shareholders) is amended by adding
14 at the end the following:

15 “(vi) In the case of a trust described
16 in clause (vi) of subparagraph (A), the in-
17 dividual for whose benefit the trust was
18 created shall be treated as a shareholder.”

19 (c) SALE OF STOCK IN IRA RELATING TO S COR-
20 PORATION ELECTION EXEMPT FROM PROHIBITED
21 TRANSACTION RULES.—Section 4975(d) of the Internal
22 Revenue Code of 1986 (relating to exemptions) is amend-
23 ed by striking “or” at the end of paragraph (14), by strik-
24 ing the period at the end of paragraph (15) and inserting
25 “; or”, and by adding at the end the following:

1 “(16) a sale of stock held by a trust which con-
2 stitutes an individual retirement account under sec-
3 tion 408(a) to the individual for whose benefit such
4 account is established if such sale is pursuant to an
5 election under section 1362(a).”

6 (d) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 2001.

9 **SEC. 3. EXCLUSION OF INVESTMENT SECURITIES INCOME**
10 **FROM PASSIVE INCOME TEST FOR BANK S**
11 **CORPORATIONS.**

12 (a) IN GENERAL.—Section 1362(d)(3)(C) of the In-
13 ternal Revenue Code of 1986 (defining passive investment
14 income) is amended by adding at the end the following:

15 “(v) EXCEPTION FOR BANKS; ETC.—
16 In the case of a bank (as defined in section
17 581), a bank holding company (as defined
18 in section 246A(c)(3)(B)(ii)), or a qualified
19 subchapter S subsidiary bank, the term
20 ‘passive investment income’ shall not in-
21 clude—

22 “(I) interest income earned by
23 such bank, bank holding company, or
24 qualified subchapter S subsidiary
25 bank, or

1 “(II) dividends on assets required
2 to be held by such bank, bank holding
3 company, or qualified subchapter S
4 subsidiary bank to conduct a banking
5 business, including stock in the Fed-
6 eral Reserve Bank, the Federal Home
7 Loan Bank, or the Federal Agricul-
8 tural Mortgage Bank or participation
9 certificates issued by a Federal Inter-
10 mediate Credit Bank.”

11 (b) EFFECTIVE DATE.—The amendment made by
12 this section shall apply to taxable years beginning after
13 December 31, 1996.

14 **SEC. 4. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
15 **HOLDERS TO 150.**

16 (a) IN GENERAL.—Section 1361(b)(1)(A) of the In-
17 ternal Revenue Code of 1986 (defining small business cor-
18 poration) is amended by striking “75 shareholders” and
19 inserting “150 shareholders (100 shareholders in the case
20 of taxable years beginning after 2001 and before 2006 and
21 125 shareholders in the case of taxable years beginning
22 after 2005 and before 2009)”.

23 (b) EFFECTIVE DATE.—The amendment made by
24 this section shall apply to taxable years beginning after
25 December 31, 2001.

1 **SEC. 5. TREATMENT OF QUALIFYING DIRECTOR SHARES.**

2 (a) IN GENERAL.—Section 1361 of the Internal Rev-
3 enue Code of 1986 is amended by adding at the end the
4 following:

5 “(f) TREATMENT OF QUALIFYING DIRECTOR
6 SHARES.—

7 “(1) IN GENERAL.—For purposes of this sub-
8 chapter—

9 “(A) qualifying director shares shall not be
10 treated as a second class of stock, and

11 “(B) no person shall be treated as a share-
12 holder of the corporation by reason of holding
13 qualifying director shares.

14 “(2) QUALIFYING DIRECTOR SHARES DE-
15 FINED.—For purposes of this subsection, the term
16 ‘qualifying director shares’ means any shares of
17 stock in a bank (as defined in section 581) or in a
18 bank holding company registered as such with the
19 Federal Reserve System—

20 “(i) which are held by an individual
21 solely by reason of status as a director of
22 such bank or company or its controlled
23 subsidiary; and

24 “(ii) which are subject to an agree-
25 ment pursuant to which the holder is re-
26 quired to dispose of the shares of stock

1 upon termination of the holder's status as
2 a director at the same price as the indi-
3 vidual acquired such shares of stock.

4 “(3) DISTRIBUTIONS.—A distribution (not in
5 part or full payment in exchange for stock) made by
6 the corporation with respect to qualifying director
7 shares shall be includible as ordinary income of the
8 holder and deductible to the corporation as an ex-
9 pense in computing taxable income under section
10 1363(b) in the year such distribution is received.”

11 (b) CONFORMING AMENDMENTS.—

12 (1) Section 1361(b)(1) of the Internal Revenue
13 Code of 1986 is amended by inserting “, except as
14 provided in subsection (f),” before “which does not”.

15 (2) Section 1366(a) of such Code is amended
16 by adding at the end the following:

17 “(3) ALLOCATION WITH RESPECT TO QUALI-
18 FYING DIRECTOR SHARES.—The holders of quali-
19 fying director shares (as defined in section 1361(f))
20 shall not, with respect to such shares of stock, be al-
21 located any of the items described in paragraph
22 (1).”

23 (3) Section 1373(a) of such Code is amended
24 by striking “and” at the end of paragraph (1), by
25 striking the period at the end of paragraph (2) and

1 inserting “, and”, and adding at the end the fol-
2 lowing:

3 “(3) no amount of an expense deductible under
4 this subchapter by reason of section 1361(f)(3) shall
5 be apportioned or allocated to such income.”

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 1996.

9 **SEC. 6. BAD DEBT CHARGE OFFS IN YEARS AFTER ELEC-**
10 **TION YEAR TREATED AS ITEMS OF BUILT-IN**
11 **LOSS.**

12 The Secretary of the Treasury shall modify Regula-
13 tion 1.1374–4(f) for S corporation elections made in tax-
14 able years beginning after December 31, 1996, with re-
15 spect to bad debt deductions under section 166 of the In-
16 ternal Revenue Code of 1986 to treat such deductions as
17 built-in losses under section 1374(d)(4) of such Code dur-
18 ing the entire period during which the bank recognizes
19 built-in gains from changing its accounting method for
20 recognizing bad debts from the reserve method under sec-
21 tion 585 of such Code to the charge-off method under sec-
22 tion 166 of such Code.

1 **SEC. 7. INCLUSION OF BANKS IN 3-YEAR S CORPORATION**
2 **RULE FOR CORPORATE PREFERENCE ITEMS.**

3 (a) **IN GENERAL.**—Section 1363(b) of the Internal
4 Revenue Code of 1986 (relating to computation of cor-
5 poration’s taxable income) is amended by adding at the
6 end the following new flush sentence:

7 “Paragraph (4) shall apply to any bank whether such
8 bank is an S corporation or a qualified subchapter S sub-
9 sidiary.”

10 (b) **EFFECTIVE DATE.**—The amendment made by
11 this section shall apply to taxable years beginning after
12 December 31, 2001.

13 **SEC. 8. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
14 **HOLDERS TO INCLUDE FAMILY LIMITED**
15 **PARTNERSHIPS.**

16 (a) **IN GENERAL.**—Section 1361(b)(1)(B) of the In-
17 ternal Revenue Code of 1986 (defining small business cor-
18 poration) is amended—

19 (1) by striking “or an organization” and insert-
20 ing “an organization”, and

21 (2) by inserting “, or a family partnership de-
22 scribed in subsection (c)(8)” after “subsection
23 (c)(6)”.

24 (b) **FAMILY PARTNERSHIP.**—Section 1361(c) of the
25 Internal Revenue Code of 1986 (relating to special rules

1 for applying subsection (b)), as amended by section 5, is
2 amended by adding at the end the following:

3 “(8) FAMILY PARTNERSHIPS.—

4 “(A) IN GENERAL.—For purposes of sub-
5 section (b)(1)(B), any partnership or limited li-
6 ability company may be a shareholder in an S
7 corporation if—

8 “(i) all partners or members are mem-
9 bers of 1 family as determined under sec-
10 tion 704(e)(3), and

11 “(ii) all of the partners or members
12 would otherwise be eligible shareholders of
13 an S corporation.

14 “(B) TREATMENT AS SHAREHOLDERS.—
15 For purposes of subsection (b)(1)(A), in the
16 case of a partnership or limited liability com-
17 pany described in subparagraph (A), each part-
18 ner or member shall be treated as a share-
19 holder.”

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years beginning after
22 December 31, 2001.

1 **SEC. 9. ISSUANCE OF PREFERRED STOCK PERMITTED.**

2 (a) IN GENERAL.—Section 1361 of the Internal Rev-
3 enue Code of 1986, as amended by section 5(a), is amend-
4 ed by adding at the end the following:

5 “(g) TREATMENT OF QUALIFIED PREFERRED
6 STOCK.—

7 “(1) IN GENERAL.—For purposes of this sub-
8 chapter—

9 “(A) qualified preferred stock shall not be
10 treated as a second class of stock, and

11 “(B) no person shall be treated as a share-
12 holder of the corporation by reason of holding
13 qualified preferred stock.

14 “(2) QUALIFIED PREFERRED STOCK DE-
15 FINED.—For purposes of this subsection, the term
16 ‘qualified preferred stock’ means stock which meets
17 the requirements of subparagraphs (A), (B), and (C)
18 of section 1504(a)(4). Stock shall not fail to be
19 treated as qualified preferred stock solely because it
20 is convertible into other stock.

21 “(3) DISTRIBUTIONS.—A distribution (not in
22 part or full payment in exchange for stock) made by
23 the corporation with respect to qualified preferred
24 stock shall be includible as ordinary income of the
25 holder and deductible to the corporation as an ex-

1 pense in computing taxable income under section
2 1363(b) in the year such distribution is received.”

3 (b) CONFORMING AMENDMENTS.—

4 (1) Section 1361(b)(1) of the Internal Revenue
5 Code of 1986, as amended by section 5(b)(1), is
6 amended by striking “subsection (f)” and inserting
7 “subsections (f) and (g)”.

8 (2) Section 1366(a) of such Code, as amended
9 by section 5(b)(2), is amended by adding at the end
10 the following:

11 “(4) ALLOCATION WITH RESPECT TO QUALI-
12 FIED PREFERRED STOCK.—The holders of qualified
13 preferred stock (as defined in section 1361(g)) shall
14 not, with respect to such stock, be allocated any of
15 the items described in paragraph (1).”

16 (3) Section 1373(a)(3) of such Code, as added
17 by section 5(b)(3), is amended by inserting “or
18 1361(g)(3)” after “section 1361(f)(3)”.

19 (c) EFFECTIVE DATE.—The amendments made by
20 this section shall apply to taxable years beginning after
21 December 31, 2001.

22 **SEC. 10. CONSENT TO ELECTIONS.**

23 (a) 90 PERCENT OF SHARES REQUIRED FOR CON-
24 SENT TO ELECTION.—Section 1362(a)(2) of the Internal

1 Revenue Code of 1986 (relating to all shareholders must
2 consent to election) is amended—

3 (1) by striking “all persons who are share-
4 holders in” and inserting “shareholders holding at
5 least 90 percent of the shares of”, and

6 (2) by striking “ALL SHAREHOLDERS” in the
7 heading and inserting “AT LEAST 90 PERCENT OF
8 SHARES”.

9 (b) RULES FOR CONSENT.—Section 1362(a) of the
10 Internal Revenue Code of 1986 (relating to election) is
11 amended by adding at the end the following:

12 “(3) RULES FOR CONSENT.—For purposes of
13 making any consent required under paragraph (2) or
14 subsection (d)(1)(B)—

15 “(A) each joint owner of shares shall con-
16 sent with respect to such shares,

17 “(B) the personal representative or other
18 fiduciary authorized to act on behalf of the es-
19 tate of a deceased individual shall consent for
20 the estate,

21 “(C) one parent, the custodian, the guard-
22 ian, or the conservator shall consent with re-
23 spect to shares owned by a minor or subject to
24 a custodianship, guardianship, conservatorship,
25 or similar arrangement,

1 “(D) the trustee of a trust shall consent
2 with respect to shares owned in trust,

3 “(E) the trustee of the estate of a bank-
4 rupt individual shall consent for shares owned
5 by a bankruptcy estate,

6 “(F) an authorized officer or the trustee of
7 an organization described in subsection (e)(6)
8 shall consent for the shares owned by such or-
9 ganization, and

10 “(G) in the case of a partnership or lim-
11 ited liability company described in subsection
12 (e)(8)—

13 “(i) all general partners shall consent
14 with respect to shares owned by such part-
15 nership,

16 “(ii) all managers shall consent with
17 respect to shares owned by such company
18 if management of such company is vested
19 in 1 or more managers, and

20 “(iii) all members shall consent with
21 respect to shares owned by such company
22 if management of such company is vested
23 in the members.”

24 (c) TREATMENT OF NONCONSENTING SHAREHOLDER
25 STOCK.—

1 (1) IN GENERAL.—Section 1361 of the Internal
2 Revenue Code of 1986, as amended by section 9(a),
3 is amended by adding at the end the following:

4 “(h) TREATMENT OF NONCONSENTING SHARE-
5 HOLDER STOCK.—

6 “(1) IN GENERAL.—For purposes of this sub-
7 chapter—

8 “(A) nonconsenting shareholder stock shall
9 not be treated as a second class of stock,

10 “(B) such stock shall be treated as C cor-
11 poration stock, and

12 “(C) the shareholder’s pro rata share
13 under section 1366(a)(1) with respect to such
14 stock shall be subject to tax paid by the S cor-
15 poration at the highest rate of tax specified in
16 section 11(b).

17 “(2) NONCONSENTING SHAREHOLDER STOCK
18 DEFINED.—For purposes of this subsection, the
19 term ‘nonconsenting shareholder stock’ means stock
20 of an S corporation which is held by a shareholder
21 who did not consent to an election under section
22 1362(a) with respect to such S corporation.

23 “(3) DISTRIBUTIONS.—A distribution (not in
24 part or full payment in exchange for stock) made by
25 the corporation with respect to nonconsenting share-

1 holder stock shall be includible as ordinary income
2 of the holder and deductible to the corporation as an
3 expense in computing taxable income under section
4 1363(b) in the year such distribution is received.”

5 (2) CONFORMING AMENDMENT.—Section
6 1361(b)(1) of the Internal Revenue Code of 1986, as
7 amended by section 9(b)(1), is amended by striking
8 “subsections (f) and (g)” and inserting “subsections
9 (f), (g), and (h)”.

10 (d) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to elections made in taxable years
12 beginning after December 31, 2001.

13 **SEC. 11. INFORMATION RETURNS FOR QUALIFIED SUB-**
14 **CHAPTER S SUBSIDIARIES.**

15 (a) IN GENERAL.—Section 1361(b)(3)(A) of the In-
16 ternal Revenue Code of 1986 (relating to treatment of cer-
17 tain wholly owned subsidiaries) is amended by inserting
18 “and in the case of information returns required under
19 part III of subchapter A of chapter 61” after “Secretary”.

20 (b) EFFECTIVE DATE.—The amendment made by
21 this section shall apply to taxable years beginning after
22 December 31, 2001.

1 **SEC. 12. ALLOWANCE OF CHARITABLE CONTRIBUTIONS OF**
2 **INVENTORY AND SCIENTIFIC PROPERTY.**

3 (a) **IN GENERAL.**—Section 170(e) of the Internal
4 Revenue Code of 1986 (relating to certain contributions
5 of ordinary income and capital gain property) is amend-
6 ed—

7 (1) by striking “(other than a corporation
8 which is an S corporation)” in paragraph (3)(A),
9 and

10 (2) by striking clause (i) of paragraph (4)(D)
11 and by redesignating clauses (ii) and (iii) of such
12 paragraph as clauses (i) and (ii), respectively.

13 (b) **STOCK BASIS ADJUSTMENT.**—Paragraph (1) of
14 section 1367(a) of such Code (relating to adjustments to
15 basis of stock of shareholders, etc.) is amended by striking
16 “and” at the end of subparagraph (B), by striking the
17 period at the end of subparagraphs (C) and inserting “,
18 and”, and by adding at the end the following new subpara-
19 graph:

20 “(D) the excess of the deductions for char-
21 itable contributions over the basis of the prop-
22 erty contributed.”

23 (c) **EFFECTIVE DATE.**—The amendment made by
24 this section shall apply to taxable years beginning after
25 December 31, 2001.

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