

109TH CONGRESS
1ST SESSION

H. R. 1557

To amend the Internal Revenue Code of 1986 to provide an election for a special tax treatment of certain S corporation conversions.

IN THE HOUSE OF REPRESENTATIVES

APRIL 12, 2005

Mrs. CUBIN 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 provide an election for a special tax treatment of certain S corporation conversions.

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 Tax
5 Flexibility Act of 2005”.

6 **SEC. 2. ELECTION FOR SPECIAL TAX TREATMENT OF CER-**
7 **TAIN S CORPORATION CONVERSIONS.**

8 (a) IN GENERAL.—Part I of subchapter S of chapter
9 1 of the Internal Revenue Code of 1986 (relating to tax

1 treatment of S corporations and their shareholders) is
2 amended by adding at the end the following new section:

3 **“SEC. 1364. ELECTION FOR SPECIAL TAX TREATMENT OF**
4 **CERTAIN S CORPORATION CONVERSIONS.**

5 “(a) IN GENERAL.—A qualified electing S corpora-
6 tion may elect the special tax treatment provided in sub-
7 section (b) for an eligible corporate conversion in the man-
8 ner set forth in subsection (f).

9 “(b) SPECIAL TAX TREATMENT.—

10 “(1) TRANSFERS TO PARTNERSHIP.—In the
11 case of transfers by a qualified electing S corpora-
12 tion to a partnership in connection with an eligible
13 corporate conversion, no gain or loss shall be recog-
14 nized by shareholders of such corporation with re-
15 spect to money or property received by the partner-
16 ship.

17 “(2) OTHER TRANSFERS.—All other distribu-
18 tions of money or property by the qualified electing
19 S corporation shall be treated as a distribution in
20 part or full payment in exchange for the stock of
21 such corporation.

22 “(c) QUALIFIED ELECTING S CORPORATION.—For
23 purposes of this section, the term ‘qualified electing S cor-
24 poration’ means a domestic corporation which—

1 “(1) has had a valid S election continuously in
2 effect for the 10 taxable years of the corporation
3 ending before the taxable year in which the election
4 under this section is made, and

5 “(2) has never made an election under this sec-
6 tion.

7 “(d) ELIGIBLE CORPORATE CONVERSION.—For pur-
8 poses of this section—

9 “(1) IN GENERAL.—The term ‘eligible cor-
10 porate conversion’ means (however affected)—

11 “(A) a transfer by a qualified electing S
12 corporation of substantially all of its assets to
13 a partnership (as defined in section 7701(a)(2))
14 for not less than 80 percent of the capital and
15 profits of the partnership in any taxable year of
16 the corporation ending on or before December
17 31, 2009,

18 “(B) the meeting of the requirement de-
19 scribed in paragraph (2) by the partnership,
20 and

21 “(C) the subsequent liquidation and dis-
22 solution of the qualified S corporation within
23 the same taxable year as the transfer.

24 “(2) CONTINUITY OF BUSINESS REQUIRE-
25 MENT.—

1 “(A) IN GENERAL.—The requirement de-
2 scribed in this paragraph is met if the partner-
3 ship described in paragraph (1)(A) either—

4 “(i) maintains the continuity of the
5 qualified electing S corporation’s business
6 for 5 consecutive taxable years following
7 the year in which the corporate conversion
8 occurs, or

9 “(ii) pays a corporate conversion re-
10 capture tax in the taxable year in which
11 the failure to maintain such continuity
12 first occurs.

13 “(B) CONTINUITY OF THE QUALIFIED
14 ELECTING S CORPORATION’S BUSINESS.—For
15 purposes of subparagraph (A)(i), the term ‘con-
16 tinuity of the qualified electing S corporation’s
17 business’ means, under all the facts and cir-
18 cumstances, either—

19 “(i) the continuation of 1 or more of
20 the S corporation’s historic lines of busi-
21 ness, or

22 “(ii) the use of a significant portion of
23 the S corporation’s historic business assets,
24 whether or not such assets have a taxable

1 basis, in the conduct of an active trade or
2 business.

3 “(C) CORPORATE CONVERSION RECAPTURE
4 TAX.—For purposes of subparagraph (A)(ii),
5 the term ‘corporate conversion recapture tax’
6 means—

7 “(i) a recomputation of the tax under
8 this subtitle of the partnership and the
9 partners as if—

10 “(I) a recomputation of the tax
11 under this subtitle of the partnership
12 and the partners as if

13 “(II) the stock of such S corpora-
14 tion was owned in the same manner
15 as the capital of the partnership, and

16 “(III) the S corporation were dis-
17 solved and its assets distributed to its
18 shareholders in complete liquidation
19 on the last day of the taxable year,
20 multiplied by

21 “(ii) a fraction—

22 “(I) the numerator of which is
23 the excess (if any) of 5 over the num-
24 ber of complete taxable years in which
25 the partnership maintains continuity

1 of the qualified electing S corpora-
2 tion's business, and

3 “(II) the denominator of which is
4 5.

5 “(e) BASIS RULES.—In the case of an eligible cor-
6 porate conversion, property in the hands of the partner-
7 ship shall have the same basis as in the hands of the quali-
8 fied electing S corporation immediately prior to the eligible
9 corporate conversion.

10 “(f) METHOD OF MAKING ELECTION.—In order to
11 elect the special tax treatment provided in subsection (b)
12 for an eligible corporate conversion, the qualified electing
13 S corporation shall file a written election claiming such
14 treatment with the timely-filed information return of the
15 S corporation for the taxable year in which the eligible
16 corporate conversion occurs.”.

17 (b) CLERICAL AMENDMENT.—The table of sections
18 for such part I is amended by adding at the end the fol-
19 lowing new item:

“Sec 1363. Election for special tax treatment of certain s corporation conver-
sions.”.

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years ending after the
22 date of the enactment of this Act.

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