

109<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# S. 1319

To amend the Internal Revenue Code of 1986 to improve the operation of employee stock ownership plans, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

JUNE 28, 2005

Mrs. LINCOLN introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to improve the operation of employee stock ownership plans, 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 “Employee Stock Own-  
5       ership Plan Promotion and Improvement Act of 2005”.

1 **SEC. 2. 10 PERCENT PENALTY TAX NOT TO APPLY TO CER-**  
2 **TAIN S CORPORATION DISTRIBUTIONS MADE**  
3 **ON STOCK HELD BY EMPLOYEE STOCK OWN-**  
4 **ERSHIP PLAN.**

5 (a) IN GENERAL.—Clause (vi) of section 72(t)(2)(A)  
6 of the Internal Revenue Code of 1986 (relating to general  
7 rule that subsection not to apply to certain distributions)  
8 is amended by inserting before the comma at the end the  
9 following: “or any distribution (as described in section  
10 1368(a)) with respect to S corporation stock that con-  
11 stitutes qualifying employer securities (as defined by sec-  
12 tion 409(l)) to the extent that such distributions are paid  
13 to a participant in the manner described in clause (i) or  
14 (ii) of section 404(k)(2)(A)”.

15 (b) EFFECTIVE DATE.—The amendments made by  
16 this section shall apply to distributions made after the  
17 date of the enactment of this Act.

18 **SEC. 3. ESOP DIVIDEND EXCEPTION TO ADJUSTMENTS**  
19 **BASED ON ADJUSTED CURRENT EARNINGS.**

20 (a) IN GENERAL.—Section 56(g)(4)(C) of the Inter-  
21 nal Revenue Code of 1986 (relating to disallowance of  
22 items not deductible in computing earnings and profits)  
23 is amended by adding at the end the following new clause:

24 “(v) TREATMENT OF ESOP DIVI-  
25 DENDS.—Clause (i) shall not apply to any  
26 deduction allowable under section 404(k) if

1 the deduction is allowed for dividends paid  
2 on employer securities held by an employee  
3 stock ownership plan established or author-  
4 ized to be established before March 15,  
5 1991.”.

6 (b) EFFECTIVE DATE.—The amendment made by  
7 this section shall apply to taxable years beginning after  
8 December 31, 1989.

9 (c) WAIVER OF LIMITATIONS.—If refund or credit of  
10 any overpayment of tax resulting from the application of  
11 the amendment made by this section is prevented at any  
12 time before the close of the 1-year period beginning on  
13 the date of the enactment of this Act by the operation  
14 of any law or rule of law (including res judicata), such  
15 refund or credit may nevertheless be made or allowed if  
16 claim therefor is filed before the close of such period.

17 **SEC. 4. AMENDMENTS RELATED TO SECTION 1042.**

18 (a) DEFERRAL OF TAX FOR CERTAIN SALES TO EM-  
19 PLOYEE STOCK OWNERSHIP PLAN SPONSORED BY S COR-  
20 PORATION.—

21 (1) IN GENERAL.—Section 1042(c)(1)(A) of the  
22 Internal Revenue Code of 1986 (defining qualified  
23 securities) is amended by striking “C”.

1           (2) EFFECTIVE DATE.—The amendment made  
2           by paragraph (1) shall apply to sales after the date  
3           of the enactment of this Act.

4           (b) REINVESTMENT IN CERTAIN MUTUAL FUNDS  
5 PERMITTED.—

6           (1) IN GENERAL.—Clause (ii) of section  
7           1042(e)(4)(B) of the Internal Revenue Code of 1986  
8           (defining operating corporation) is amended to read  
9           as follows:

10                   “(ii) FINANCIAL INSTITUTIONS, IN-  
11                   SURANCE COMPANIES, AND MUTUAL  
12                   FUNDS.—The term ‘operating corporation’  
13                   shall include—

14                           “(I) any financial institution de-  
15                           scribed in section 581,

16                           “(II) any insurance company  
17                           subject to tax under subchapter L,  
18                           and

19                           “(III) any regulated investment  
20                           company if substantially all of the se-  
21                           curities held by such company are se-  
22                           curities issued by operating corpora-  
23                           tions (determined without regard to  
24                           this subclause).”.

1           (2) EFFECTIVE DATE.—The amendment made  
2           by paragraph (1) shall apply to sales of qualified se-  
3           curities after the date of the enactment of this Act.

4           (c) MODIFICATION TO 25-PERCENT SHAREHOLDER  
5           RULE.—

6           (1) IN GENERAL.—Subparagraph (B) of section  
7           409(n)(1) of the Internal Revenue Code of 1986 (re-  
8           lating to securities received in certain transactions)  
9           is amended to read as follows:

10                   “(B) for the benefit of any other person  
11                   who owns (after the application of section  
12                   318(a)) more than 25 percent of—

13                           “(i) the total combined voting power  
14                           of all classes of stock of the corporation  
15                           which issued such employer securities or of  
16                           any corporation which is a member of the  
17                           same controlled group of corporations  
18                           (within the meaning of subsection (l)(4))  
19                           as such corporation, or

20                                   “(ii) the total value of all classes of  
21                                   stock of any such corporation.”.

22           (2) EFFECTIVE DATE.—The amendment made  
23           by paragraph (1) shall take effect on the date of the  
24           enactment of this Act.

1 **SEC. 5. EARLY DISTRIBUTIONS FROM EMPLOYEE STOCK**  
 2 **OWNERSHIP PLANS FOR HIGHER EDUCATION**  
 3 **EXPENSES AND FIRST-TIME HOMEBUYER**  
 4 **PURCHASES.**

5 (a) IN GENERAL.—Paragraph (2) of section 72(t) of  
 6 the Internal Revenue Code of 1986 (relating to 10-percent  
 7 additional tax on early distributions from qualified retire-  
 8 ment plans) is amended by adding at the end the following  
 9 new subparagraph:

10 “(G) DISTRIBUTIONS FROM EMPLOYEE  
 11 STOCK OWNERSHIP PLANS FOR HIGHER EDU-  
 12 CATION EXPENSES AND FIRST-TIME HOME-  
 13 BUYER PURCHASES.—

14 “(i) IN GENERAL.—Distributions  
 15 made to the employee from an employee  
 16 stock ownership plan (within the meaning  
 17 of section 4975(e)(7)), the amount of  
 18 which does not exceed the sum of—

19 “(I) qualified higher education  
 20 expenses (as defined by paragraph  
 21 (7)) reduced by the amount of such  
 22 expenses taken into account under  
 23 subparagraph (E), and

24 “(II) qualified first-time home-  
 25 buyer distributions (as defined by  
 26 paragraph (8)) reduced by the amount

1 of such distributions taken into ac-  
2 count under subparagraph (F).

3 “(ii) LIMITATION.—A distribution  
4 may only be taken into account under  
5 clause (i) if—

6 “(I) such distribution is in the  
7 form of either employer securities  
8 (within the meaning of section 409(l))  
9 or cash proceeds resulting from the  
10 sale of such securities made not more  
11 than 180 days before the date of such  
12 distribution for the purposes of such  
13 distribution,

14 “(II) such securities so distrib-  
15 uted or sold were held by such plan  
16 for at least 5 years before the date of  
17 such distribution or, if applicable,  
18 sale, and

19 “(III) the number of shares in  
20 each class of such securities so dis-  
21 tributed or sold, when added to all  
22 previous distributions and sales of  
23 each such class of such securities for  
24 such purposes on behalf of such em-  
25 ployee, does not exceed 10 percent of

1 the aggregate number of shares of  
2 each class of such securities allocated  
3 to the account of such employee under  
4 such plan.

5 “(iii) VALUATION OF DISTRIBUTED  
6 SECURITIES.—For purposes of clause (ii),  
7 the value of a security shall be the value  
8 of such security on the date of distribu-  
9 tion.”.

10 (b) CONFORMING AMENDMENTS.—

11 (1) Paragraph (7) of section 72(t) of such Code  
12 is amended by striking “paragraph (2)(E)” and in-  
13 sserting “subparagraphs (E) and (G) of paragraph  
14 (2)”.

15 (2) Paragraph (8) of section 72(t) of such Code  
16 is amended by striking “paragraph (2)(F)” and in-  
17 sserting “subparagraphs (F) and (G) of paragraph  
18 (2)”.

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

22 **SEC. 6. DE MINIMIS EXCEPTION TO DIVERSIFICATION OF**  
23 **INVESTMENT REQUIREMENT.**

24 (a) IN GENERAL.—Paragraph (28) of section 401(a)  
25 of the Internal Revenue Code of 1986 (relating to addi-



1 tional requirements relating to employee stock ownership  
2 plans) is amended by adding at the end the following new  
3 subparagraph:

4           “(D) EXCEPTION FOR DE MINIMIS AC-  
5           COUNT BALANCE.—A plan shall not fail to meet  
6           the requirements of this subparagraph for a  
7           plan year solely because the plan provides that  
8           clause (i) does not apply to any participant’s  
9           account in the plan which, as of the close of the  
10          preceding plan year, has an account balance  
11          which does not exceed \$2,500.”.

12          (b) EFFECTIVE DATE.—The amendment made by  
13 this section shall apply to plan years beginning after the  
14 date of the enactment of this Act.

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