

110TH CONGRESS
1ST SESSION

H. R. 4840

To amend the Internal Revenue Code of 1986 to provide for S corporation reform, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 19, 2007

Mr. KIND (for himself, Mr. RAMSTAD, Mrs. JONES of Ohio, Mr. ENGLISH of Pennsylvania, Ms. SCHWARTZ, Mr. SAM JOHNSON of Texas, and Mr. KAGEN) 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 for S corporation reform, 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, REFERENCE.**

4 (a) SHORT TITLE.—This Act may be cited as the “S
5 Corporation Modernization Act of 2007”.

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. REDUCED RECOGNITION PERIOD FOR BUILT-IN**
4 **GAINS.**

5 (a) **IN GENERAL.**—Paragraph (7) of section 1374(d)
6 (relating to definitions and special rules) is amended as
7 follows:

8 “(7) **RECOGNITION PERIOD.**—The term ‘rec-
9 ognition period’ means the 7-year period beginning
10 with the 1st day of the 1st taxable year for which
11 the corporation was an S corporation. For purposes
12 of applying this section to any amount includible in
13 income by reason of distributions to shareholders
14 pursuant to section 593(e), the preceding sentence
15 shall be applied without regard to the duration of
16 the recognition period in effect on the date of such
17 distribution.”.

18 (b) **EFFECTIVE DATE.**—The amendment made by
19 this section—

20 (1) shall apply for purposes of determining the
21 recognition period with respect to 1st days referred
22 to in section 1374(d)(7) of the Internal Revenue
23 Code of 1986 occurring before, on, or after the date
24 of the enactment of this Act, but

1 (2) shall not apply for purposes of determining
2 the tax imposed by section 1374 of such Code for
3 taxable years ending before such date.

4 **SEC. 3. EXPANSION OF QUALIFYING BENEFICIARIES OF AN**
5 **ELECTING SMALL BUSINESS TRUST.**

6 (a) NO LOOK THROUGH FOR ELIGIBILITY PUR-
7 POSES.—Clause (v) of section 1361(c)(2)(B) (relating to
8 treatment as shareholders) is amended by adding at the
9 end the following new sentence: “This clause shall not
10 apply for purposes of subsection (b)(1)(C).”.

11 (b) EFFECTIVE DATE.—The amendment made by
12 this section shall take effect on the date of the enactment
13 of this Act.

14 **SEC. 4. REPEAL OF EXCESSIVE PASSIVE INVESTMENT IN-**
15 **COME AS A TERMINATION EVENT.**

16 (a) IN GENERAL.—Section 1362(d) (relating to ter-
17 mination) is amended by striking paragraph (3).

18 (b) CONFORMING AMENDMENTS.—

19 (1) Section 1362(f)(1) is amended by striking
20 “or (3)”.

21 (2) Clause (i) of section 1042(c)(4)(A) is
22 amended by striking “section 1362(d)(3)(C)” and
23 inserting “section 1375(b)(3)”.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years beginning after
3 December 31, 2007.

4 **SEC. 5. MODIFICATIONS TO PASSIVE INCOME RULES.**

5 (a) INCREASED LIMIT.—

6 (1) IN GENERAL.—Paragraph (2) of section
7 1375(a) (relating to tax imposed when passive in-
8 vestment income of corporation having accumulated
9 earnings and profits exceeds 25 percent of gross re-
10 cepts) is amended by striking “25 percent” and in-
11 serting “60 percent”.

12 (2) CONFORMING AMENDMENTS.—

13 (A) Subparagraph (J) of section 26(b)(2)
14 is amended by striking “25 percent” and insert-
15 ing “60 percent”.

16 (B) Clause (i) of section 1375(b)(1)(A) is
17 amended by striking “25 percent” and inserting
18 “60 percent”.

19 (C) The heading for section 1375 is
20 amended by striking “**25 PERCENT**” and in-
21 serting “**60 PERCENT**”.

22 (D) The table of sections for part III of
23 subchapter S of chapter 1 is amended by strik-
24 ing “25 percent” in the item relating to section
25 1375 and inserting “60 percent”.

1 (b) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years beginning after
3 December 31, 2007.

4 **SEC. 6. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
5 **HOLDERS TO INCLUDE IRAS.**

6 (a) IN GENERAL.—Clause (vi) of section
7 1361(c)(2)(A) (relating to certain trusts permitted as
8 shareholders) is amended to read as follows:

9 “(vi) A trust which constitutes an in-
10 dividual retirement account under section
11 408(a), including one designated as a Roth
12 IRA under section 408A.”.

13 (b) SALE OF STOCK IN IRA RELATING TO S COR-
14 PORATION ELECTION EXEMPT FROM PROHIBITED
15 TRANSACTION RULES.—Paragraph (16) of section
16 4975(d) (relating to exemptions) is amended to read as
17 follows:

18 “(16) a sale of stock held by a trust which con-
19 stitutes an individual retirement account under sec-
20 tion 408(a) to the individual for whose benefit such
21 account is established if—

22 “(A) such sale is pursuant to an election
23 under section 1362(a) by the issuer of such
24 stock,

1 “(B) such sale is for fair market value at
2 the time of sale (as established by an inde-
3 pendent appraiser) and the terms of the sale
4 are otherwise at least as favorable to such trust
5 as the terms that would apply on a sale to an
6 unrelated party,

7 “(C) such trust does not pay any commis-
8 sions, costs, or other expenses in connection
9 with the sale, and

10 “(D) the stock is sold in a single trans-
11 action for cash not later than 120 days after
12 the S corporation election is made.”.

13 (c) EFFECTIVE DATE.—The amendments made by
14 this section shall take effect on the date of the enactment
15 of this Act.

16 **SEC. 7. ALLOWANCE OF DEDUCTION FOR CHARITABLE**
17 **CONTRIBUTIONS FOR ELECTING SMALL BUSI-**
18 **NESS TRUSTS.**

19 (a) IN GENERAL.—Section 641(c)(2)(C) (relating to
20 modifications) is amended by adding at the end the fol-
21 lowing new sentence: “The deduction for charitable con-
22 tributions allowed under clause (i) shall be determined
23 without regard to section 642(c), and the limitations im-
24 posed by section 170(b)(1) on the amount of the deduction

1 shall be applied to the electing small business trust as if
2 it were an individual.”.

3 (b) **EFFECTIVE DATE.**—The amendment made by
4 this section shall apply to taxable years beginning after
5 the date of the enactment of this Act.

6 **SEC. 8. ENTITY NEUTRALITY STUDY.**

7 Not later than December 31, 2009, the Comptroller
8 General of the United States shall conduct a study on enti-
9 ty neutrality under the Internal Revenue Code of 1986
10 and shall submit a report to the Committee on Ways and
11 Means of the House of Representatives which—

12 (1) discusses the challenges to providing equal
13 treatment between S corporations and limited liabil-
14 ity companies under the Internal Revenue Code of
15 1986,

16 (2) identifies the differences under the Internal
17 Revenue Code of 1986 between the various pass-
18 through entity rules, and

19 (3) discusses why entities would prefer one set
20 of rules over another.

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