

103D CONGRESS
1ST SESSION

S. 363

To amend the Internal Revenue Code of 1986 to provide a 50 percent exclusion for gain from certain small business stock, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 16 (legislative day, JANUARY 5), 1993

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

A BILL

To amend the Internal Revenue Code of 1986 to provide a 50 percent exclusion for gain from certain small business stock, 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, ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “_____”.

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. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN**
 4 **SMALL BUSINESS STOCK.**

5 (a) GENERAL RULE.—Part I of subchapter P of
 6 chapter 1 (relating to capital gains and losses) is amended
 7 by adding at the end thereof the following new section:

8 **“SEC. 1202. 50-PERCENT EXCLUSION FOR GAIN FROM CER-**
 9 **TAIN SMALL BUSINESS STOCK.**

10 “(a) GENERAL RULE.—Gross income shall not in-
 11 clude 50 percent of any gain from the sale or exchange
 12 of qualified small business stock held for more than 2
 13 years.

14 “(b) QUALIFIED SMALL BUSINESS STOCK.—For
 15 purposes of this section—

16 “(1) IN GENERAL.—Except as otherwise pro-
 17 vided in this section, the term ‘qualified small busi-
 18 ness stock’ means any stock in a corporation which
 19 is originally issued on or after January 1, 1993, if—

20 “(A) as of the date of issuance, such cor-
 21 poration is a qualified small business, and

22 “(B) except as provided in subsections (d)
 23 and (e), such stock is acquired by the taxpayer
 24 at its original issue (directly or through an un-
 25 derwriter)—

1 “(i) in exchange for money or other
2 property (not including stock), or

3 “(ii) as compensation for services
4 (other than services performed as an un-
5 derwriter of such stock).

6 “(2) ACTIVE BUSINESS REQUIREMENT.—Stock
7 in a corporation shall not be treated as qualified
8 small business stock unless, during substantially all
9 of the taxpayer’s holding period for such stock, such
10 corporation meets the active business requirements
11 of subsection (d).

12 “(3) CERTAIN PURCHASES BY CORPORATION OF
13 ITS OWN STOCK.—

14 “(A) IN GENERAL.—Stock issued by a cor-
15 poration shall not be treated as qualified small
16 business stock if such corporation has pur-
17 chased or purchases any of its stock within the
18 5-year period beginning 1 year before the date
19 of the issuance of such stock.

20 “(B) EXCEPTION WHERE BUSINESS PUR-
21 POSE.—Subparagraph (A) shall not apply
22 where the issuing corporation establishes that
23 there was a business purpose for the purchase
24 of the stock and such purchase is not inconsis-
25 tent with the purposes of this section.

1 “(C) MEMBERS OF AFFILIATED GROUP.—
2 For purposes of this paragraph, the purchase
3 by any corporation which is a member of the
4 same affiliated group (within the meaning of
5 section 1504) as the issuing corporation of any
6 stock in any corporation which is a member of
7 such group shall be treated as a purchase by
8 the issuing corporation of its stock.

9 “(c) QUALIFIED SMALL BUSINESS.—For purposes of
10 this section—

11 “(1) IN GENERAL.—The term ‘qualified small
12 business’ means any domestic corporation if—

13 “(A) the aggregate capitalization of such
14 corporation (or any predecessor thereof) at all
15 times on or after January 1, 1993 and before
16 the issuance did not exceed \$25,000,000, and

17 “(B) the aggregate capitalization of such
18 corporation immediately after the issuance (de-
19 termined by taking into account amounts to be
20 received in the issuance) does not exceed
21 \$25,000,000.

22 “(2) AGGREGATE CAPITALIZATION.—For pur-
23 poses of paragraph (1), the term ‘aggregate capital-
24 ization’ means the excess of—

1 “(A) the amount of cash and the aggregate
2 adjusted bases of other property held by the
3 corporation, over

4 “(B) the aggregate amount of the short-
5 term indebtedness of the corporation.

6 For purposes of the preceding sentence, the term
7 ‘short-term indebtedness’ means any indebtedness
8 which, when incurred, did not have a term in excess
9 of 1 year.

10 “(3) LOOK-THRU IN CASE OF SUBSIDIARIES.—
11 In determining whether a corporation meets the re-
12 quirements of this subsection—

13 “(A) stock and debt of any subsidiary (as
14 defined in subsection (d)(4)(C)) held by such
15 corporation shall be disregarded, and

16 “(B) such corporation shall be treated as
17 holding its ratable share of the assets of such
18 subsidiary and as being liable for its ratable
19 share of the indebtedness of such subsidiary.

20 “(d) ACTIVE BUSINESS REQUIREMENT.—For pur-
21 poses of this section—

22 “(1) IN GENERAL.—For purposes of subsection
23 (b)(2), the requirements of this subsection are met
24 for any period if during such period—

1 “(A) the corporation is engaged in the ac-
2 tive conduct of a trade or business,

3 “(B) substantially all of the assets of such
4 corporation are used in the active conduct of a
5 trade or business, and

6 “(C) such corporation is an eligible cor-
7 poration.

8 “(2) SPECIAL RULE FOR CERTAIN ACTIVI-
9 TIES.—For purposes of paragraph (1), if, in connec-
10 tion with any future trade or business, a corporation
11 is engaged in—

12 “(A) start-up activities described in section
13 195(c)(1)(A),

14 “(B) activities resulting in the payment or
15 incurring of expenditures which may be treated
16 as research and experimental expenditures
17 under section 174, or

18 “(C) activities with respect to in-house re-
19 search expenses described in section 41(b)(4),
20 such corporation shall be treated with respect to
21 such activities as engaged in (and assets used in
22 such activities shall be treated as used in) the active
23 conduct of a trade or business. Any determination
24 under this paragraph shall be made without regard

1 to whether a corporation has any gross income from
2 such activities at the time of the determination.

3 “(3) ELIGIBLE CORPORATION.—For purposes
4 of this subsection—

5 “(A) IN GENERAL.—The term ‘eligible cor-
6 poration’ means any domestic corporation; ex-
7 cept that such term shall not include—

8 “(i) any corporation predominantly
9 engaged in a disqualified business,

10 “(ii) any corporation the principal ac-
11 tivity of which is the performance of per-
12 sonal services,

13 “(iii) a DISC,

14 “(iv) a corporation with respect to
15 which an election under 936 is in effect,

16 “(v) any regulated investment com-
17 pany, real estate investment trust, or
18 REMIC,

19 “(vi) any cooperative, and

20 “(vii) in the case of a corporate share-
21 holder, any corporation which at any time
22 was a subsidiary (as defined in paragraph
23 (4)(C)) of such corporate shareholder.

24 “(B) DISQUALIFIED BUSINESS.—The term
25 ‘disqualified business’ means—

1 “(i) any banking, insurance, financ-
2 ing, or similar business,

3 “(ii) any farming business (other than
4 the business of raising or harvesting trees),

5 “(iii) any business involving the pro-
6 duction or extraction of products of a char-
7 acter with respect to which a deduction is
8 allowable under section 613 or 613A, and

9 “(iv) any business of operating a
10 hotel, motel, or restaurant or similar busi-
11 ness.

12 “(4) STOCK IN OTHER CORPORATIONS.—

13 “(A) LOOK-THRU IN CASE OF SUBSIDI-
14 ARIES.—For purposes of this subsection, stock
15 and debt in any subsidiary corporation shall be
16 disregarded and the parent corporation shall be
17 deemed to own its ratable share of the subsidi-
18 ary’s assets, and to conduct its ratable share of
19 the subsidiary’s activities.

20 “(B) PORTFOLIO STOCK OR SECURITIES.—

21 A corporation shall be treated as failing to meet
22 the requirements of paragraph (1) for any pe-
23 riod during which more than 10 percent of the
24 value of its assets (in excess of liabilities) con-
25 sist of stock or securities in other corporations

1 which are not subsidiaries of such corporation
2 (other than assets described in paragraph (5)).

3 “(C) SUBSIDIARY.—For purposes of this
4 paragraph, a corporation shall be considered a
5 subsidiary if the parent owns more than 50 per-
6 cent of the combined voting power of all classes
7 of stock entitled to vote, or more than 50 per-
8 cent in value of all outstanding stock, of such
9 corporation.

10 “(5) WORKING CAPITAL.—For purposes of
11 paragraph (1)(B), any assets which—

12 “(A) are held for investment, and

13 “(B) are to be used to finance future re-
14 search and experimentation or working capital
15 needs of the corporation,

16 shall be treated as used in the active conduct of a
17 trade or business.

18 “(6) MAXIMUM REAL ESTATE HOLDINGS.—A
19 corporation shall not be treated as meeting the re-
20 quirements of paragraph (1) for any period during
21 which more than 10 percent of the total value of its
22 assets is real property which is not used in the ac-
23 tive conduct of a trade or business. For purposes of
24 the preceding sentence, the ownership of, dealing in,

1 or renting of real property shall not be treated as
2 the active conduct of a trade or business.

3 “(7) COMPUTER SOFTWARE ROYALTIES.—For
4 purposes of paragraph (1), rights to computer soft-
5 ware which produces income described in section
6 543(d) shall be treated as an asset used in the active
7 conduct of a trade or business.

8 “(e) STOCK ACQUIRED ON CONVERSION OF PRE-
9 FERRED STOCK.—If any stock is acquired through the
10 conversion of other stock which is qualified small business
11 stock in the hands of the taxpayer—

12 “(1) the stock so acquired shall be treated as
13 qualified small business stock in the hands of the
14 taxpayer, and

15 “(2) the stock so acquired shall be treated as
16 having been held during the period during which the
17 converted stock was held.

18 “(f) TREATMENT OF PASS-THRU ENTITIES.—

19 “(1) IN GENERAL.—Any amount included in in-
20 come by reason of holding an interest in a pass-thru
21 entity shall be treated as gain described in sub-
22 section (a) if such amount meets the requirements
23 of paragraph (2).

24 “(2) REQUIREMENTS.—An amount meets the
25 requirements of this paragraph if—

1 “(A) such amount is attributable to gain
2 on the sale or exchange by the pass-thru entity
3 of stock which is qualified small business stock
4 in the hands of such entity and which was held
5 by such entity for more than 2 years, and

6 “(B) such amount is includible in the gross
7 income of the taxpayer by reason of the holding
8 of an interest in such entity which was held by
9 the taxpayer on the date on which such pass-
10 thru entity acquired such stock and at all times
11 thereafter before the disposition of such stock
12 by such pass-thru entity.

13 “(3) LIMITATION BASED ON INTEREST ORIGI-
14 NALLY HELD BY TAXPAYER.—Paragraph (1) shall
15 not apply to any amount to the extent such amount
16 exceeds the amount to which paragraph (1) would
17 have applied if such amount were determined by ref-
18 erence to the interest the taxpayer held in the pass-
19 thru entity on the date the qualified small business
20 stock was acquired.

21 “(4) PASS-THRU ENTITY.—For purposes of this
22 subsection, the term ‘pass-thru entity’ means—

23 “(A) any partnership,

24 “(B) any S corporation,

1 “(C) any regulated investment company,
2 and

3 “(D) any common trust fund.

4 “(g) CERTAIN TAX-FREE AND OTHER TRANS-
5 FERS.—For purposes of this section—

6 “(1) IN GENERAL.—In the case of a transfer of
7 stock to which this subsection applies, the transferee
8 shall be treated as—

9 “(A) having acquired such stock in the
10 same manner as the transferor, and

11 “(B) having held such stock during any
12 continuous period immediately preceding the
13 transfer during which it was held (or treated as
14 held under this subsection) by the transferor.

15 “(2) TRANSFERS TO WHICH SUBSECTION AP-
16 PLIES.—This subsection shall apply to any trans-
17 fer—

18 “(A) by gift,

19 “(B) at death,

20 “(C) from a partnership to a partner of
21 stock with respect to which the requirements of
22 subsection (f) are met at the time of the trans-
23 fer (without regard to the 2-year holding re-
24 quirement), or

1 “(D) to the extent that the basis of the
2 property in the hands of the transferee is deter-
3 mined by reference to the basis of the property
4 in the hands of the transferor by reason of sec-
5 tion 334(b), but only if requirements similar to
6 the requirements of subsection (f) are met with
7 respect to the stock.

8 “(3) CERTAIN RULES MADE APPLICABLE.—
9 Rules similar to the rules of section 1244(d)(2) shall
10 apply for purposes of this section.

11 “(4) INCORPORATIONS AND REORGANIZATIONS
12 INVOLVING NONQUALIFIED STOCK.—

13 “(A) IN GENERAL.—In the case of a trans-
14 action described in section 351 or a reorganiza-
15 tion described in section 368, if a qualified
16 small business stock is transferred for other
17 stock, such transfer shall be treated as a trans-
18 fer to which this subsection applies solely with
19 respect to the person receiving such other stock.

20 “(B) LIMITATION.—This section shall
21 apply to the sale or exchange of stock treated
22 as qualified small business stock by reason of
23 subparagraph (A) only to the extent of the gain
24 (if any) which would have been recognized at
25 the time of the transfer described in subpara-

1 graph (A) if section 351 or 368 had not applied
2 at such time.

3 “(C) SUCCESSIVE APPLICATION.—For pur-
4 poses of this paragraph, stock treated as quali-
5 fied small business stock under subparagraph
6 (A) shall be so treated for subsequent trans-
7 actions or reorganizations, except that the limi-
8 tation of subparagraph (B) shall be applied as
9 of the time of the first transfer to which sub-
10 subparagraph (A) applied.

11 “(D) CONTROL TEST.—Except in the case
12 of a transaction described in section 368, this
13 paragraph shall apply only if, immediately after
14 the transaction, the corporation issuing the
15 stock owns directly or indirectly stock rep-
16 resenting control (within the meaning of section
17 368(c)) of the corporation whose stock was
18 transferred.

19 “(h) BASIS RULES.—

20 “(1) STOCK EXCHANGED FOR PROPERTY.—For
21 purposes of this section, in the case where the tax-
22 payer transfers property (other than money or
23 stock) to a corporation in exchange for stock in such
24 corporation—

1 “(A) such stock shall be treated as having
2 been acquired by the taxpayer on the date of
3 such exchange, and

4 “(B) the basis of such stock in the hands
5 of the taxpayer shall in no event be less than
6 the fair market value of the property ex-
7 changed.

8 “(2) BASIS OF S CORPORATION STOCK.—For
9 purposes of this section, the adjusted basis of stock
10 in an S corporation shall in no event be less than
11 its adjusted basis determined without regard to any
12 adjustment to the basis of such stock under section
13 1367.

14 “(i) REGULATIONS.—The Secretary shall prescribe
15 such regulations as may be appropriate to carry out the
16 purposes of this section, including regulations to prevent
17 the avoidance of the purposes of this section through split-
18 ups or otherwise.”

19 (b) EXCLUSION TREATED AS PREFERENCE FOR MIN-
20 IMUM TAX.—

21 (1) IN GENERAL.—Subsection (a) of section 57
22 (relating to items of tax preference) is amended by
23 adding at the end thereof the following new para-
24 graph:

1 “(8) EXCLUSION FOR GAINS ON SALE OF CER-
2 TAIN SMALL BUSINESS STOCK.—An amount equal to
3 the amount excluded from gross income for the tax-
4 able year under section 1202.”.

5 (2) CONFORMING AMENDMENT.—Subclause (II)
6 of section 53(d)(2)(B)(ii) is amended by striking
7 “and (6)” and inserting “(6), and (8)”.

8 (c) CONFORMING AMENDMENTS.—

9 (1)(A) Section 172(d)(2) (relating to modifica-
10 tions with respect to net operating loss deduction) is
11 amended to read as follows:

12 “(2) CAPITAL GAINS AND LOSSES OF TAX-
13 PAYERS OTHER THAN CORPORATIONS.—In the case
14 of a taxpayer other than a corporation—

15 “(A) the amount deductible on account of
16 losses from sales or exchanges of capital assets
17 shall not exceed the amount includable on ac-
18 count of gains from sales or exchanges of cap-
19 ital assets; and

20 “(B) the exclusion provided by section
21 1202 shall not be allowed.”.

22 (B) Subparagraph (B) of section 172(d)(4) is
23 amended by inserting “, (2)(B),” after “paragraph
24 (1)”.

1 (2) Paragraph (4) of section 642(c) is amended
2 to read as follows:

3 “(4) ADJUSTMENTS.—To the extent that the
4 amount otherwise allowable as a deduction under
5 this subsection consists of gain described in section
6 1202(a), proper adjustment shall be made for any
7 exclusion allowable to the estate or trust under sec-
8 tion 1202. In the case of a trust, the deduction al-
9 lowed by this subsection shall be subject to section
10 681 (relating to unrelated business income).”.

11 (3) Paragraph (3) of section 643(a) is amended
12 by adding at the end thereof the following new sen-
13 tence: “The exclusion under section 1202 shall not
14 be taken into account.”.

15 (4) Paragraph (4) of section 691(c) is amended
16 by striking “1201, and 1211” and inserting “1201,
17 1202, and 1211”.

18 (5) The second sentence of paragraph (2) of
19 section 871(a) is amended by inserting “such gains
20 and losses shall be determined without regard to sec-
21 tion 1202 and” after “except that”.

22 (6) The table of sections for part I of sub-
23 chapter P of chapter 1 is amended by adding after
24 the item relating to section 1201 the following new
25 item:

“Sec. 1202. 50-percent exclusion for gain from certain small business stock.”.

1 (d) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to stock issued on or after Jan-
3 uary 1, 1993.

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S 363 IS—2