

104TH CONGRESS
1ST SESSION

H. R. 1785

To amend the Internal Revenue Code of 1986 to promote capital formation for the development of new businesses.

IN THE HOUSE OF REPRESENTATIVES

JUNE 7, 1995

Mr. ZIMMER (for himself, Mr. SCHUMER, and Mr. CHRISTENSEN) 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 promote capital formation for the development of new businesses.

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 “Entrepreneurial New
5 and Small Business Capital Formation Act of 1995”.

6 **SEC. 2. ROLLOVER OF CAPITAL GAINS ON CERTAIN SMALL**
7 **BUSINESS INVESTMENTS.**

8 (a) IN GENERAL.—Part III of subchapter O of chap-
9 ter 1 of the Internal Revenue Code of 1986 (relating to

1 common nontaxable exchanges) is amended by adding at
2 the end the following new section:

3 **“SEC. 1045. ROLLOVER OF GAIN ON SMALL BUSINESS IN-**
4 **VESTMENTS.**

5 “(a) NONRECOGNITION OF GAIN.—In the case of the
6 sale of any eligible small business investment with respect
7 to which the taxpayer elects the application of this section,
8 gain from such sale shall be recognized only to the extent
9 that the amount realized on such sale exceeds—

10 “(1) the cost of any other eligible small busi-
11 ness investment purchased by the taxpayer during
12 the 6-month period beginning on the date of such
13 sale, reduced by

14 “(2) any portion of such cost previously taken
15 into account under this section.

16 This section shall not apply to any gain which is treated
17 as ordinary income for purposes of this subtitle.

18 “(b) DEFINITIONS AND SPECIAL RULES.—For pur-
19 poses of this section—

20 “(1) PURCHASE.—The term ‘purchase’ has the
21 meaning given such term by section 1043(b)(4).

22 “(2) ELIGIBLE SMALL BUSINESS INVEST-
23 MENT.—Except as otherwise provided in this sec-
24 tion, the term ‘eligible small business investment’
25 means any stock in a domestic corporation, and any

1 partnership interest in a domestic partnership,
2 which is originally issued after December 31, 1994,
3 if—

4 “(A) as of the date of issuance, such cor-
5 poration or partnership is a qualified small
6 business entity, and

7 “(B) such stock or partnership interest is
8 acquired by the taxpayer at its original issue
9 (directly or through an underwriter)—

10 “(i) in exchange for money or other
11 property (not including stock), or

12 “(ii) as compensation for services
13 (other than services performed as an un-
14 derwriter of such stock or partnership in-
15 terest).

16 A rule similar to the rule of section 1202(c)(3) shall
17 apply for purposes of this section.

18 “(3) ACTIVE BUSINESS REQUIREMENT.—Stock
19 in a corporation, and a partnership interest in a
20 partnership, shall not be treated as eligible small
21 business investment unless, during substantially all
22 of the taxpayer’s holding period for such stock or
23 partnership interest, such corporation or partnership
24 meets the active business requirements of subsection
25 (c). A rule similar to the rule of section

1 1202(c)(2)(B) shall apply for purposes of this sec-
2 tion.

3 “(4) QUALIFIED SMALL BUSINESS ENTITY.—

4 “(A) IN GENERAL.—The term ‘qualified
5 small business entity’ means any domestic cor-
6 poration or partnership if—

7 “(i) for the taxable year of such entity
8 in which the stock or partnership interest
9 was issued and each prior taxable year,
10 such entity (and any predecessor thereof)
11 had gross receipts of less than
12 \$20,000,000,

13 “(ii) at all times before such issuance,
14 such entity (and any predecessor thereof)
15 had aggregate gross assets (as defined in
16 section 1202(d)(2)) of less than
17 \$25,000,000, and

18 “(iii) at all times before such issu-
19 ance, the excess of the fair market value of
20 the assets of such entity (and any prede-
21 cessor thereof) over the liabilities of such
22 entity was less than \$10,000,000.

23 “(B) AGGREGATION RULES.—All persons
24 treated as a single employer under subsection

1 (a) or (b) of section 52 shall be treated as one
2 person for purposes of subparagraph (A).

3 “(C) SPECIAL RULES FOR DETERMINING
4 GROSS RECEIPTS.—The rules of subparagraphs
5 (B) and (C) of section 448(c)(3) shall apply for
6 purposes of subparagraph (A)(i).

7 “(c) ACTIVE BUSINESS REQUIREMENT.—

8 “(1) IN GENERAL.—For purposes of subsection
9 (b)(3), the requirements of this subsection are met
10 by a qualified small business entity for any period
11 if—

12 “(A) the entity is engaged in the active
13 conduct of a trade or business, and

14 “(B) at least 80 percent (by value) of the
15 assets of such entity are used in the active con-
16 duct of a trade or business.

17 “(2) SPECIAL RULE FOR CERTAIN ACTIVI-
18 TIES.—For purposes of paragraph (1), if, in connec-
19 tion with any future trade or business, an entity is
20 engaged in—

21 “(A) startup activities described in section
22 195(c)(1)(A),

23 “(B) activities resulting in the payment or
24 incurring of expenditures which may be treated

1 as research and experimental expenditures
2 under section 174, or

3 “(C) activities with respect to in-house re-
4 search expenses described in section 41(b)(4),
5 such entity shall be treated with respect to such ac-
6 tivities as engaged in (and assets used in such activi-
7 ties shall be treated as used in) the active conduct
8 of a trade or business. Any determination under this
9 paragraph shall be made without regard to whether
10 the entity has any gross income from such activities
11 at the time of the determination.

12 “(3) CERTAIN RULES TO APPLY.—Rules similar
13 to the rules of paragraphs (5), (6), (7), and (8) of
14 section 1202(e) shall apply for purposes of this sub-
15 section.

16 “(d) CERTAIN OTHER RULES TO APPLY.—Rules
17 similar to the rules of subsections (f), (g), (h), and (j)
18 of section 1202 (without regard to any 5-year holding pe-
19 riod requirement) shall apply for purposes of this section.

20 “(e) BASIS ADJUSTMENTS.—If gain from any sale is
21 not recognized by reason of subsection (a), such gain shall
22 be applied to reduce (in the order acquired) the basis for
23 determining gain or loss of any eligible small business in-
24 vestment which is purchased by the taxpayer during the
25 6-month period described in subsection (a).

1 “(f) STATUTE OF LIMITATIONS.—If any gain is real-
2 ized by the taxpayer on the sale or exchange of any eligible
3 small business investment and there is in effect an election
4 under subsection (a) with respect to such gain, then—

5 “(1) the statutory period for the assessment of
6 any deficiency with respect to such gain shall not ex-
7 pire before the expiration of 3 years from the date
8 the Secretary is notified by the taxpayer (in such
9 manner as the Secretary may by regulations pre-
10 scribe) of—

11 “(A) the taxpayer’s cost of purchasing
12 other eligible small business investment which
13 the taxpayer claims results in nonrecognition of
14 any part of such gain,

15 “(B) the taxpayer’s intention not to pur-
16 chase other eligible small business investment
17 within the 6-month period described in sub-
18 section (a), or

19 “(C) a failure to make such purchase with-
20 in such 6-month period, and

21 “(2) such deficiency may be assessed before the
22 expiration of such 3-year period notwithstanding the
23 provisions of any other law or rule of law which
24 would otherwise prevent such assessment.

1 “(g) REGULATIONS.—The Secretary shall prescribe
2 such regulations as may be appropriate to carry out the
3 purposes of this section, including regulations to prevent
4 the avoidance of the purposes of this section through
5 splitups, shell corporations, partnerships, or otherwise.”

6 (b) CONFORMING AMENDMENT.—Paragraph (23) of
7 section 1016(a) of such Code is amended—

8 (1) by striking “or 1044” and inserting “,
9 1044, or 1045”, and

10 (2) by striking “or 1044(d)” and inserting “,
11 1044(d), or 1045(e)”.

12 (c) CLERICAL AMENDMENT.—The table of sections
13 for part III of subchapter O of chapter 1 of such Code
14 is amended by adding at the end the following new item:

“Sec. 1045. Rollover of gain on small business investments.”

15 (d) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to taxable years ending after De-
17 cember 31, 1994.

18 **SEC. 3. LOSSES ON ELIGIBLE SMALL BUSINESS INVEST-**
19 **MENTS.**

20 (a) IN GENERAL.—Part IV of subchapter P of chap-
21 ter 1 of the Internal Revenue Code of 1986 (relating to
22 special rules for determining gains and losses) is amended
23 by inserting after section 1244 the following new section:

1 **“SEC. 1244A. LOSSES ON ELIGIBLE SMALL BUSINESS IN-**
2 **VESTMENTS.**

3 “If—

4 “(1) a loss is on any eligible small business in-
5 vestment (as defined in section 1045(b)), and

6 “(2) such loss would (but for this section) be a
7 loss from the sale or exchange of a capital asset,
8 then such loss shall be treated as an ordinary loss. For
9 purposes of section 172 (relating to the net operating loss
10 deduction), any amount of loss treated by reason of this
11 section as an ordinary loss shall be treated as attributable
12 to a trade or business of the taxpayer.”

13 (b) CLERICAL AMENDMENT.—The table of sections
14 for such part IV is amended by inserting after the item
15 relating to section 1244 the following new item:

“Sec. 1244A. Losses on eligible small business investments.”

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to taxable years ending after De-
18 cember 31, 1994.

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