

105TH CONGRESS  
1ST SESSION

# S. 74

To amend the Internal Revenue Code of 1986 to limit the tax rate for certain small businesses, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

JANUARY 21, 1997

Mr. KYL 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 limit the tax rate for certain small businesses, 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 “Small Business Invest-  
5 ment and Growth Act”.

6 **SEC. 2. SMALL BUSINESS TAX RATE.**

7       (a) IN GENERAL.—Section 1 of the Internal Revenue  
8 Code of 1986 (relating to tax imposed) is amended by add-  
9 ing at the end the following new subsection:

10       “(i) MAXIMUM SMALL BUSINESS TAX RATE.—

1           “(1) IN GENERAL.—Except as provided in para-  
2           graph (4), if a taxpayer has taxable small business  
3           income for any taxable year to which this subsection  
4           applies, then the tax imposed by this section shall  
5           not exceed the sum of—

6                   “(A) a tax computed at the rates and in  
7                   the same manner as if this subsection had not  
8                   been enacted on the greater of—

9                           “(i) taxable income reduced by the  
10                           amount of taxable small business income,  
11                           or

12                           “(ii) the amount of taxable income  
13                           taxed at a rate below 34 percent, plus

14                   “(B) a tax of 34 percent of the amount of  
15                   taxable income in excess of the taxable income  
16                   that is subject to tax under subparagraph (A).

17           “(2) TAXABLE SMALL BUSINESS INCOME.—For  
18           purposes of this subsection, the term ‘taxable small  
19           business income’ means, with respect to any taxable  
20           year, the taxable income of the taxpayer for such  
21           year attributable to the active conduct of any trade  
22           or business of an eligible small business.

23           “(3) QUALIFIED RETAINED EARNINGS AC-  
24           COUNT.—For purposes of this subsection—

1           “(A) S CORPORATIONS.—Each S corpora-  
2           tion shall establish a qualified retained earnings  
3           account which shall be—

4                   “(i) increased each year by the por-  
5                   tion of the taxable income of the S cor-  
6                   poration that is attributable to the active  
7                   conduct of a trade or business by the S  
8                   corporation,

9                   “(ii) decreased each year by the por-  
10                  tion of the taxable loss of the S corpora-  
11                  tion that is attributable to such active con-  
12                  duct of a trade or business, and

13                  “(iii) decreased by qualified and non-  
14                  qualified distributions from such S cor-  
15                  poration to the shareholders thereof.

16           “(B) QUALIFIED DISTRIBUTIONS.—For  
17           purposes of subparagraph (A), a distribution  
18           from a qualified retained earnings account shall  
19           be treated as a qualified distribution if the dis-  
20           tribution—

21                   “(i) is made to the owners of the eligi-  
22                   ble small business, and

1           “(ii) is made to enable the S corpora-  
2           tion shareholder to pay income taxes (Fed-  
3           eral, State, local) on the income of the eli-  
4           gible small business.

5           The Secretary is authorized to promulgate reg-  
6           ulations pursuant to this subparagraph to pro-  
7           vide rules to determine the extent to which dis-  
8           tributions by an S corporation are made to en-  
9           able the distributee to pay its income taxes, in-  
10          cluding regulations that establish a presumption  
11          that distributions are to enable the distributee  
12          to pay income taxes if such distributions do not  
13          exceed 34 percent of taxable small business in-  
14          come.

15           “(C) DISTRIBUTIONS AFTER TAXABLE  
16          YEAR.—For purposes of subparagraph (B), a  
17          distribution from a qualified retained earnings  
18          account within 75 days after the end of a tax-  
19          able year of the eligible small business may be  
20          treated as a distribution made on the last day  
21          of such taxable year.

22           “(4) ADDITIONAL TAX ON NONQUALIFIED DIS-  
23          TRIBUTIONS.—

24           “(A) IN GENERAL.—If—

1           “(i) a distribution other than a quali-  
2           fied distribution is made from a qualified  
3           retained earnings account, and

4           “(ii) such distribution is made from  
5           additions to the account for a taxable year  
6           with respect to which paragraph (1)(B) ap-  
7           plied to the taxpayer by reason of such ad-  
8           ditions,

9           then the tax imposed by this section for the tax-  
10          able year of the taxpayer with or within which  
11          the taxable year of the eligible small business in  
12          which the distribution was made ends shall be  
13          increased by the amount determined under sub-  
14          paragraph (B).

15          “(B) AMOUNT OF ADDITIONAL TAX.—The  
16          amount of tax determined under this subpara-  
17          graph is an amount equal to the product of the  
18          taxpayer’s pro rata share of the distribution de-  
19          scribed in subparagraph (A)(i) and the number  
20          of percentage points (and fractions thereof) by  
21          which the highest rate of tax in effect under  
22          this section for the taxpayer’s taxable year ex-  
23          ceeds 34 percent.

24          “(C) ORDER OF DISTRIBUTIONS.—For  
25          purposes of this paragraph, distributions shall

1 be treated as having been made from the quali-  
2 fied retained earnings account on a last-in,  
3 first-out basis. Distributions in excess of the  
4 balance of the qualified retained earnings ac-  
5 count shall not reduce such account below zero.

6 “(5) ELIGIBLE SMALL BUSINESS.—For pur-  
7 poses of this subsection—

8 “(A) IN GENERAL.—Except as provided in  
9 subparagraph (B), the term ‘eligible small busi-  
10 ness’ means, with respect to any taxable year,  
11 an S corporation which has been designated, as  
12 of the beginning of the taxable year, as a small  
13 business concern (within the meaning of section  
14 3(a) of the Small Business Act) according to  
15 size standard regulations published by the  
16 Small Business Administration.

17 “(B) EXCLUSIONS.—Such term shall not  
18 include—

19 “(i) any personal service corporation  
20 (as defined in section 469(j)(2)), and

21 “(ii) any personal holding company  
22 (as defined in section 542).

23 “(C) ELECTION TO USE 3 PRECEDING  
24 YEARS.—If the determination under subpara-  
25 graph (A) is made on the basis of number of

1 employees or gross receipts, the taxpayer may  
2 elect to have the determination made on the  
3 basis of the average number of employees or the  
4 average gross receipts of the taxpayer for the 3  
5 taxable years preceding the taxable year.

6 “(6) YEARS TO WHICH SUBSECTION APPLIES.—  
7 This subsection shall apply to any taxable year if the  
8 highest rate of tax set forth in subsection (a), (b),  
9 (c), (d), or (e) (whichever applies) for the taxable  
10 year exceeds 34 percent.

11 “(7) REGULATIONS.—The Secretary shall pre-  
12 scribe such regulations as may be necessary or ap-  
13 propriate to carry out the purposes of this section,  
14 including regulations preventing the characterization  
15 of distributions for purposes of compensation or per-  
16 sonal use as distributions of qualified retained earn-  
17 ings.”

18 (b) EFFECTIVE DATE.—The amendment made by  
19 subsection (a) shall apply to taxable years beginning after  
20 December 31, 1997.

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