

107TH CONGRESS  
1ST SESSION

# S. 936

To amend the Internal Revenue Code of 1986 to expand S corporation eligibility for banks, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

MAY 23, 2001

Mr. ALLARD (for himself, Mr. JOHNSON, and Mr. THOMAS) 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 expand S corporation eligibility for banks, 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 and  
5 Financial Institutions Tax Relief Act of 2001”.

6 **SEC. 2. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**  
7 **HOLDERS TO INCLUDE IRAS.**

8 (a) IN GENERAL.—Section 1361(c)(2)(A) of the In-  
9 ternal Revenue Code of 1986 (relating to certain trusts

1 permitted as shareholders) is amended by inserting after  
2 clause (v) the following:

3 “(vi) A trust which constitutes an in-  
4 dividual retirement account under section  
5 408(a), including one designated as a Roth  
6 IRA under section 408A.”.

7 (b) TREATMENT AS SHAREHOLDER.—Section  
8 1361(c)(2)(B) of the Internal Revenue Code of 1986 (re-  
9 lating to treatment as shareholders) is amended by adding  
10 at the end the following:

11 “(vi) In the case of a trust described  
12 in clause (vi) of subparagraph (A), the in-  
13 dividual for whose benefit the trust was  
14 created shall be treated as a shareholder.”.

15 (c) SALE OF STOCK IN IRA RELATING TO S COR-  
16 PORATION ELECTION EXEMPT FROM PROHIBITED  
17 TRANSACTION RULES.—Section 4975(d) of the Internal  
18 Revenue Code of 1986 (relating to exemptions) is amend-  
19 ed by striking “or” at the end of paragraph (14), by strik-  
20 ing the period at the end of paragraph (15) and inserting  
21 “; or”, and by adding at the end the following:

22 “(16) a sale of stock held by a trust which con-  
23 stitutes an individual retirement account under sec-  
24 tion 408(a) to the individual for whose benefit such

1 account is established if such sale is pursuant to an  
2 election under section 1362(a).”.

3 (d) CONFORMING AMENDMENT.—Section 512(e)(1)  
4 of the Internal Revenue Code of 1986 is amended by in-  
5 serting “1361(c)(2)(A)(vi) or” before “1361(c)(6)”.

6 (e) EFFECTIVE DATE.—The amendments made by  
7 this section shall apply to trusts which constitute indi-  
8 vidual retirement accounts on the date of the enactment  
9 of this Act in taxable years beginning after December 31,  
10 2001.

11 **SEC. 3. EXCLUSION OF INVESTMENT SECURITIES INCOME**  
12 **FROM PASSIVE INCOME TEST FOR BANK S**  
13 **CORPORATIONS.**

14 (a) IN GENERAL.—Section 1362(d)(3)(C) of the In-  
15 ternal Revenue Code of 1986 (defining passive investment  
16 income) is amended by adding at the end the following:

17 “(v) EXCEPTION FOR BANKS; ETC.—  
18 In the case of a bank (as defined in section  
19 581), a bank holding company (as defined  
20 in section 246A(c)(3)(B)(ii)), or a qualified  
21 subchapter S subsidiary bank, the term  
22 ‘passive investment income’ shall not  
23 include—

24 “(I) interest income earned by  
25 such bank, bank holding company, or

1 qualified subchapter S subsidiary  
2 bank, or

3 “(II) dividends on assets required  
4 to be held by such bank, bank holding  
5 company, or qualified subchapter S  
6 subsidiary bank to conduct a banking  
7 business, including stock in the Fed-  
8 eral Reserve Bank, the Federal Home  
9 Loan Bank, or the Federal Agricul-  
10 tural Mortgage Bank or participation  
11 certificates issued by a Federal Inter-  
12 mediate Credit Bank.”.

13 (b) EFFECTIVE DATE.—The amendment made by  
14 this section shall apply to taxable years beginning after  
15 December 31, 1996.

16 **SEC. 4. INCREASE IN NUMBER OF ELIGIBLE SHARE-**  
17 **HOLDERS TO 150.**

18 (a) IN GENERAL.—Section 1361(b)(1)(A) of the In-  
19 ternal Revenue Code of 1986 (defining small business cor-  
20 poration) is amended by striking “75” and inserting  
21 “150”.

22 (b) EFFECTIVE DATE.—The amendment made by  
23 this section shall apply to taxable years beginning after  
24 December 31, 2001.

1 **SEC. 5. TREATMENT OF QUALIFYING DIRECTOR SHARES.**

2 (a) IN GENERAL.—Section 1361 of the Internal Rev-  
3 enue Code of 1986 (defining S corporation) is amended  
4 by adding at the end the following:

5 “(f) TREATMENT OF QUALIFYING DIRECTOR  
6 SHARES.—

7 “(1) IN GENERAL.—For purposes of this  
8 subchapter—

9 “(A) qualifying director shares shall not be  
10 treated as a second class of stock, and

11 “(B) no person shall be treated as a share-  
12 holder of the corporation by reason of holding  
13 qualifying director shares.

14 “(2) QUALIFYING DIRECTOR SHARES DE-  
15 FINED.—For purposes of this subsection, the term  
16 ‘qualifying director shares’ means any shares of  
17 stock in a bank (as defined in section 581) or in a  
18 bank holding company registered as such with the  
19 Federal Reserve System—

20 “(i) which are held by an individual  
21 solely by reason of status as a director of  
22 such bank or company or its controlled  
23 subsidiary; and

24 “(ii) which are subject to an agree-  
25 ment pursuant to which the holder is re-  
26 quired to dispose of the shares of stock

1           upon termination of the holder's status as  
2           a director at the same price as the indi-  
3           vidual acquired such shares of stock.

4           “(3) DISTRIBUTIONS.—A distribution (not in  
5           part or full payment in exchange for stock) made by  
6           the corporation with respect to qualifying director  
7           shares shall be includible as ordinary income of the  
8           holder and deductible to the corporation as an ex-  
9           pense in computing taxable income under section  
10          1363(b) in the year such distribution is received.”.

11          (b) CONFORMING AMENDMENTS.—

12           (1) Section 1361(b)(1) of the Internal Revenue  
13          Code of 1986 is amended by inserting “, except as  
14          provided in subsection (f),” before “which does not”.

15           (2) Section 1366(a) of such Code is amended  
16          by adding at the end the following:

17           “(3) ALLOCATION WITH RESPECT TO QUALI-  
18          FYING DIRECTOR SHARES.—The holders of quali-  
19          fying director shares (as defined in section 1361(f))  
20          shall not, with respect to such shares of stock, be al-  
21          located any of the items described in paragraph  
22          (1).”.

23           (3) Section 1373(a) of such Code is amended  
24          by striking “and” at the end of paragraph (1), by  
25          striking the period at the end of paragraph (2) and

1 inserting “, and”, and adding at the end the fol-  
2 lowing:

3 “(3) no amount of an expense deductible under  
4 this subchapter by reason of section 1361(f)(3) shall  
5 be apportioned or allocated to such income.”.

6 (c) EFFECTIVE DATE.—The amendments made by  
7 this section shall apply to taxable years beginning after  
8 December 31, 1996.

9 **SEC. 6. BAD DEBT CHARGE OFFS IN YEARS AFTER ELEC-**  
10 **TION YEAR TREATED AS ITEMS OF BUILT-IN**  
11 **LOSS.**

12 The Secretary of the Treasury shall modify Regula-  
13 tion 1.1374–4(f) for S corporation elections made in tax-  
14 able years beginning after December 31, 1996, with re-  
15 spect to bad debt deductions under section 166 of the In-  
16 ternal Revenue Code of 1986 to treat such deductions as  
17 built-in losses under section 1374(d)(4) of such Code dur-  
18 ing the entire period during which the bank recognizes  
19 built-in gains from changing its accounting method for  
20 recognizing bad debts from the reserve method under sec-  
21 tion 585 of such Code to the charge-off method under sec-  
22 tion 166 of such Code.

1 **SEC. 7. INCLUSION OF BANKS IN 3-YEAR S CORPORATION**

2 **RULE FOR CORPORATE PREFERENCE ITEMS.**

3 (a) **IN GENERAL.**—Section 1363(b) of the Internal  
4 Revenue Code of 1986 (relating to computation of cor-  
5 poration’s taxable income) is amended by adding at the  
6 end the following new flush sentence:

7 “Paragraph (4) shall apply to any bank whether such  
8 bank is an S corporation or a qualified subchapter S sub-  
9 sidiary.”.

10 (b) **EFFECTIVE DATE.**—The amendment made by  
11 this section shall apply to taxable years beginning after  
12 December 31, 2001.

13 **SEC. 8. C CORPORATION RULES TO APPLY FOR FRINGE**

14 **BENEFIT PURPOSES.**

15 (a) **IN GENERAL.**—Section 1372 of the Internal Rev-  
16 enue Code of 1986 (relating to partnership rules to apply  
17 for fringe benefit purposes) is repealed.

18 (b) **PARTNERSHIP RULES TO APPLY FOR HEALTH**  
19 **INSURANCE COSTS OF CERTAIN S CORPORATION SHARE-**  
20 **HOLDERS.**—Paragraph (5) of section 162(l) of the Inter-  
21 nal Revenue Code of 1986 (relating to special rules for  
22 health insurance costs of self-employed individuals) is  
23 amended to read as follows:

24 “(5) **TREATMENT OF CERTAIN S CORPORATION**  
25 **SHAREHOLDERS.**—

1           “(A) IN GENERAL.—This subsection shall  
2 apply in the case of any 2-percent shareholder  
3 of an S corporation, except that—

4           “(i) for purposes of this subsection,  
5 such shareholder’s wages (as defined in  
6 section 3121) from the S corporation shall  
7 be treated as such shareholder’s earned in-  
8 come (within the meaning of section  
9 401(c)(1)), and

10           “(ii) there shall be such adjustments  
11 in the application of this subsection as the  
12 Secretary may by regulations prescribe.

13           “(B) 2-PERCENT SHAREHOLDER DE-  
14 FINED.—For purposes of this paragraph, the  
15 term ‘2-percent shareholder’ means any person  
16 who owns (or is considered as owning within  
17 the meaning of section 318) on any day during  
18 the taxable year of the S corporation more than  
19 2 percent of the outstanding stock of such cor-  
20 poration or stock possessing more than 2 per-  
21 cent of the total combined voting power of all  
22 stock of such corporation.”.

23           (c) CONFORMING AMENDMENT.—The table of sec-  
24 tions for part III of subchapter S of chapter 1 of the Inter-

1 nal Revenue Code of 1986 is amended by striking the item  
2 relating to section 1372.

3 (d) EFFECTIVE DATE.—The amendments made by  
4 this section shall apply to taxable years beginning after  
5 December 31, 2001.

6 **SEC. 9. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**  
7 **HOLDERS TO INCLUDE FAMILY LIMITED**  
8 **PARTNERSHIPS.**

9 (a) IN GENERAL.—Section 1361(b)(1)(B) of the In-  
10 ternal Revenue Code of 1986 (defining small business cor-  
11 poration) is amended—

12 (1) by striking “or an organization” and insert-  
13 ing “an organization”, and

14 (2) by inserting “, or a family partnership de-  
15 scribed in subsection (c)(7)” after “subsection  
16 (c)(6)”.

17 (b) FAMILY PARTNERSHIP.—Section 1361(e) of the  
18 Internal Revenue Code of 1986 (relating to special rules  
19 for applying subsection (b)) is amended by adding at the  
20 end the following:

21 “(7) FAMILY PARTNERSHIPS.—

22 “(A) IN GENERAL.—For purposes of sub-  
23 section (b)(1)(B), any partnership or limited li-  
24 ability company may be a shareholder in an S  
25 corporation if—

1           “(i) all partners or members are mem-  
 2           bers of 1 family as determined under sec-  
 3           tion 704(e)(3), and

4           “(ii) all of the partners or members  
 5           would otherwise be eligible shareholders of  
 6           an S corporation.

7           “(B) TREATMENT AS SHAREHOLDERS.—  
 8           For purposes of subsection (b)(1)(A), in the  
 9           case of a partnership or limited liability com-  
 10          pany described in subparagraph (A), each part-  
 11          ner or member shall be treated as a share-  
 12          holder.”.

13          (c) EFFECTIVE DATE.—The amendments made by  
 14          this section shall apply to taxable years beginning after  
 15          December 31, 2001.

16          **SEC. 10. ISSUANCE OF PREFERRED STOCK PERMITTED.**

17          (a) IN GENERAL.—Section 1361 of the Internal Rev-  
 18          enue Code of 1986 (defining s corporation), as amended  
 19          by section 5(a), is amended by adding at the end the fol-  
 20          lowing:

21                 “(g) TREATMENT OF QUALIFIED PREFERRED  
 22          STOCK.—

23                         “(1) IN GENERAL.—For purposes of this  
 24          subchapter—

1           “(A) qualified preferred stock shall not be  
2           treated as a second class of stock, and

3           “(B) no person shall be treated as a share-  
4           holder of the corporation by reason of holding  
5           qualified preferred stock.

6           “(2) QUALIFIED PREFERRED STOCK DE-  
7           FINED.—For purposes of this subsection, the term  
8           ‘qualified preferred stock’ means stock which meets  
9           the requirements of subparagraphs (A), (B), and (C)  
10          of section 1504(a)(4). Stock shall not fail to be  
11          treated as qualified preferred stock solely because it  
12          is convertible into other stock.

13          “(3) DISTRIBUTIONS.—A distribution (not in  
14          part or full payment in exchange for stock) made by  
15          the corporation with respect to qualified preferred  
16          stock shall be includible as ordinary income of the  
17          holder and deductible to the corporation as an ex-  
18          pense in computing taxable income under section  
19          1363(b) in the year such distribution is received.”.

20          (b) CONFORMING AMENDMENTS.—

21                 (1) Section 1361(b)(1) of the Internal Revenue  
22                 Code of 1986, as amended by section 5(b)(1), is  
23                 amended by striking “subsection (f)” and inserting  
24                 “subsections (f) and (g)”.



1           “(D) the excess of the deductions for char-  
2           itable contributions over the basis of the prop-  
3           erty contributed.”.

4           (b) **EFFECTIVE DATE.**—The amendment made by  
5 this section shall apply to taxable years beginning after  
6 December 31, 2001.

7 **SEC. 12. CONSENT TO ELECTIONS.**

8           (a) **90 PERCENT OF SHARES REQUIRED FOR CON-**  
9 **SENT TO ELECTION.**—Section 1362(a)(2) of the Internal  
10 Revenue Code of 1986 (relating to all shareholders must  
11 consent to election) is amended—

12           (1) by striking “all persons who are share-  
13 holders in” and inserting “shareholders holding at  
14 least 90 percent of the shares of”, and

15           (2) by striking “ALL SHAREHOLDERS” in the  
16 heading and inserting “AT LEAST 90 PERCENT OF  
17 SHARES”.

18           (b) **RULES FOR CONSENT.**—Section 1362(a) of the  
19 Internal Revenue Code of 1986 (relating to election) is  
20 amended by adding at the end the following:

21           “(3) **RULES FOR CONSENT.**—For purposes of  
22 making any consent required under paragraph (2) or  
23 subsection (d)(1)(B)—

24           “(A) each joint owner of shares shall con-  
25 sent with respect to such shares,

1           “(B) the personal representative or other  
2           fiduciary authorized to act on behalf of the es-  
3           tate of a deceased individual shall consent for  
4           the estate,

5           “(C) one parent, the custodian, the guard-  
6           ian, or the conservator shall consent with re-  
7           spect to shares owned by a minor or subject to  
8           a custodianship, guardianship, conservatorship,  
9           or similar arrangement,

10           “(D) the trustee of a trust shall consent  
11           with respect to shares owned in trust,

12           “(E) the trustee of the estate of a bank-  
13           rupt individual shall consent for shares owned  
14           by a bankruptcy estate,

15           “(F) an authorized officer or the trustee of  
16           an organization described in subsection (e)(6)  
17           shall consent for the shares owned by such or-  
18           ganization, and

19           “(G) in the case of a partnership or lim-  
20           ited liability company described in subsection  
21           (c)(8)—

22           “(i) all general partners shall consent  
23           with respect to shares owned by such part-  
24           nership,

1           “(ii) all managers shall consent with  
 2           respect to shares owned by such company  
 3           if management of such company is vested  
 4           in 1 or more managers, and

5           “(iii) all members shall consent with  
 6           respect to shares owned by such company  
 7           if management of such company is vested  
 8           in the members.”.

9           (c) TREATMENT OF NONCONSENTING SHAREHOLDER  
 10 STOCK.—

11           (1) IN GENERAL.—Section 1361 of the Internal  
 12           Revenue Code of 1986 (defining s corporation), as  
 13           amended by section 10(a), is amended by adding at  
 14           the end the following:

15           “(h) TREATMENT OF NONCONSENTING SHARE-  
 16           HOLDER STOCK.—

17           “(1) IN GENERAL.—For purposes of this  
 18           subchapter—

19           “(A) nonconsenting shareholder stock shall  
 20           not be treated as a second class of stock,

21           “(B) such stock shall be treated as C cor-  
 22           poration stock, and

23           “(C) the shareholder’s pro rata share  
 24           under section 1366(a)(1) with respect to such  
 25           stock shall be subject to tax paid by the S cor-

1           poration at the highest rate of tax specified in  
2           section 11(b).

3           “(2) NONCONSENTING SHAREHOLDER STOCK  
4           DEFINED.—For purposes of this subsection, the  
5           term ‘nonconsenting shareholder stock’ means stock  
6           of an S corporation which is held by a shareholder  
7           who did not consent to an election under section  
8           1362(a) with respect to such S corporation.

9           “(3) DISTRIBUTIONS.—A distribution (not in  
10          part or full payment in exchange for stock) made by  
11          the corporation with respect to nonconsenting share-  
12          holder stock shall be includible as ordinary income  
13          of the holder and deductible to the corporation as an  
14          expense in computing taxable income under section  
15          1363(b) in the year such distribution is received.”.

16          (2) CONFORMING AMENDMENT.—Section  
17          1361(b)(1) of the Internal Revenue Code of 1986, as  
18          amended by section 10(b)(1), is amended by striking  
19          “subsections (f) and (g)” and inserting “subsections  
20          (f), (g), and (h)”.

21          (d) EFFECTIVE DATE.—The amendments made by  
22          this section shall apply to elections made in taxable years  
23          beginning after December 31, 2001.

1 **SEC. 13. INFORMATION RETURNS FOR QUALIFIED SUB-**  
2 **CHAPTER S SUBSIDIARIES.**

3 (a) **IN GENERAL.**—Section 1361(b)(3)(A) of the In-  
4 ternal Revenue Code of 1986 (relating to treatment of cer-  
5 tain wholly owned subsidiaries) is amended by inserting  
6 “and in the case of information returns required under  
7 part III of subchapter A of chapter 61” after “Secretary”.

8 (b) **EFFECTIVE DATE.**—The amendment made by  
9 this section shall apply to taxable years beginning after  
10 December 31, 2001.

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