

108TH CONGRESS
2D SESSION

H. R. 4137

To amend the Internal Revenue Code of 1986 to provide for unified income taxation with respect to pass-thru entities.

IN THE HOUSE OF REPRESENTATIVES

APRIL 2, 2004

Mr. HOUGHTON 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 unified income taxation with respect to pass-thru entities.

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 “Small Business Tax Mod-
5 ernization Act of 2004”.

6 **SEC. 2. UNIFIED PASS-THRU ENTITY REGIME.**

7 (a) TERMINATION OF S CORPORATION STATUS.—

8 (1) NO NEW S CORPORATION ELECTIONS.—

9 Subsection (a) of section 1362 of the Internal Rev-

1 enue Code of 1986 is amended by adding at the end
2 the following new paragraph:

3 “(3) TERMINATION OF AUTHORITY TO MAKE
4 ELECTION.—No election may be made under para-
5 graph (1) for any taxable year beginning after De-
6 cember 31, 2004.”.

7 (2) TERMINATION OF STATUS.—Subsection (d)
8 of section 1362 of such Code (relating to termi-
9 nation) is amended by adding at the end the fol-
10 lowing new paragraph:

11 “(4) TREATMENT AS PARTNERSHIP AFTER
12 2014.—An election under subsection (a)—

13 “(A) shall not be effective for any taxable
14 year beginning after December 31, 2014, and

15 “(B) shall be treated as an election under
16 section 7701(a)(2)(B) for taxable years begin-
17 ning after such date.”.

18 (3) EFFECTIVE DATE.—The amendments made
19 by this subsection shall apply to taxable years begin-
20 ning after December 31, 2004.

21 (b) ELECTION BY CERTAIN CORPORATIONS TO BE
22 TAXED AS PARTNERSHIP.—

23 (1) IN GENERAL.—Paragraph (2) of section
24 7701(a) of such Code (defining partnership and
25 partner) is amended to read as follows:

1 “(2) PARTNERSHIP AND PARTNER.—

2 “(A) IN GENERAL.—The term ‘partner-
3 ship’ includes a syndicate, group, pool, joint
4 venture, or other unincorporated organization,
5 through or by means of which any business, fi-
6 nancial operation, or venture is carried on, and
7 which is not, within the meaning of this title,
8 a trust or estate or a corporation; and the term
9 ‘partner’ includes a member in such a syn-
10 dicate, group, pool, joint venture, or organiza-
11 tion.

12 “(B) ELECTION BY CORPORATION TO BE
13 TAXED AS PARTNERSHIP.—

14 “(i) IN GENERAL.—An eligible cor-
15 poration may elect to be treated as a part-
16 nership for purposes of this title.

17 “(ii) TAX TREATMENT.—Except as
18 provided in section 1379A—

19 “(I) no gain or loss shall be rec-
20 ognized to the corporation or the
21 shareholders by reason of an election
22 under clause (i), and

23 “(II) except in the case of an
24 election made by a S corporation after
25 the end of the recognition period (as

1 defined in section 1374(d)(7) without
2 regard to subparagraph (B) thereof),
3 section 1374 shall apply to the entity
4 after such election.

5 “(iii) ELIGIBLE CORPORATION.—For
6 purposes of clause (i), the term ‘eligible
7 corporation’ means an entity—

8 “(I) which, without regard to this
9 subparagraph, is a domestic corpora-
10 tion no stock of which is readily
11 tradable on an established securities
12 market or otherwise, and

13 “(II) which is not an ineligible
14 corporation (as defined by section
15 1361(b)(2)).

16 “(iv) ELECTION AND TERMINATION.—
17 For purposes of this subparagraph, rules
18 similar to the rules of section 1362 (other
19 than subsections (a)(3), (d)(3) and (4),
20 and (e) thereof) shall apply.

21 “(v) DISTRIBUTIONS, ETC.—Each
22 partner shall include in gross income as a
23 dividend, any amount that would have been
24 so includible had the entity been an S cor-
25 poration during the period the entity was

1 treated as a partnership. Notwithstanding
2 the preceding sentence, the provisions of
3 subchapter K of chapter 1 shall apply to
4 determine the basis of any property dis-
5 tributed and the basis of any interest in
6 the partnership.

7 “(vi) CROSS REFERENCE.—For tax
8 treatment of S corporation electing unified
9 pass-thru regime, see section 1379A.”.

10 (2) TAX TREATMENT OF S CORPORATION
11 ELECTING UNIFIED PASS-THRU REGIME.—

12 (A) IN GENERAL.—Part IV of subchapter
13 S of chapter 1 of such Code is amended by in-
14 serting after section 1379 the following new
15 section:

16 **“SEC. 1379A. TAX TREATMENT OF S CORPORATION ELECT-**
17 **ING UNIFIED PASS-THRU REGIME.**

18 “In the case of an election under section
19 7701(a)(2)(B) by an S corporation before January 1,
20 2015, with respect to the corporation—

21 “(1) the shareholders shall be treated as if the
22 assets were distributed, on the date of such election,
23 to the shareholders in exchange for their stock,

24 “(2) any gain or loss recognized to the share-
25 holders by reason of paragraph (1) shall be taken

1 into account by the shareholders ratably over the
2 taxable year in which the distribution is deemed to
3 be made under paragraph (1) and the succeeding 4
4 taxable years, and

5 “(3) proper adjustments to the basis of inter-
6 ests in the entity shall be made.”.

7 (B) CLERICAL AMENDMENT.—The table of
8 sections for part IV of subchapter S of chapter
9 1 of such Code is amended by inserting after
10 the item relating to section 1379 the following
11 new item:

“Sec. 1379A. Tax treatment of S corporation electing unified pass-thru re-
gime.”.

12 (3) MODIFICATION TO TREATMENT OF SECTION
13 1374 TAX FOR EARNINGS AND PROFITS PURPOSES.—
14 Paragraph (2) of section 1366(f) of such Code is
15 amended to read as follows:

16 “(2) TREATMENT OF TAX IMPOSED ON BUILT-
17 IN GAINS.—

18 “(A) IN GENERAL.—The amount of the
19 items of the net recognized built-in gain taken
20 into account under section 1374(b)(1) (reduced
21 by any deduction allowed under section
22 1374(b)(2)) shall not be taken into account
23 under this section.

1 “(B) EARNINGS AND PROFITS.—The accu-
2 mulated earnings and profits of the corporation
3 shall be increased at the beginning of the tax-
4 able year by the amount not taken into account
5 under this section by reason of subparagraph
6 (A) (determined without regard to section
7 1374(b)(2)) reduced by the tax imposed by sec-
8 tion 1374 (net of credits allowed).”.

9 (4) EFFECT OF ELECTION ON RECOGNITION
10 PERIOD FOR PURPOSES OF TAX IMPOSED ON BUILT-
11 IN GAINS.—Paragraph (7) of section 1374(d) of
12 such Code is amended to read as follows:

13 “(7) RECOGNITION PERIOD.—

14 “(A) IN GENERAL.—The term ‘recognition
15 period’ means the 10-year period beginning
16 with the 1st day of the 1st taxable year for
17 which the corporation was an S corporation.
18 For purposes of applying this section to any
19 amount includible in income by reason of sec-
20 tion 593(e), the preceding sentence shall be ap-
21 plied without regard to the phrase ‘10-year’.

22 “(B) SPECIAL RULE RELATING TO ELEC-
23 TION OF CORPORATION TO BE TAXED AS PART-
24 NERSHIP.—

1 “(i) IN GENERAL.—In the case of an
2 election under section 7701(a)(2)(B), sub-
3 paragraph (A) shall be applied by sub-
4 stituting ‘25-year’ for ‘10-year’ both places
5 it appears.

6 “(ii) EXCEPTION WHERE 10-YEAR PE-
7 RIOD EXPIRED.—If, on the date of an elec-
8 tion referred to in clause (i) by a corpora-
9 tion, the 10-year period specified in sub-
10 paragraph (A) with respect to such cor-
11 poration has expired, clause (i) shall not
12 apply to such corporation.”.

13 (5) EFFECTIVE DATES.—The amendments
14 made by this subsection shall apply to taxable years
15 beginning after December 31, 2004.

16 (c) STEP TRANSACTION DOCTRINE NOT TO APPLY
17 TO PARTNERSHIP INCORPORATION FOLLOWED BY COR-
18 PORATE REORGANIZATION.—

19 (1) IN GENERAL.—Section 351 of such Code is
20 amended by redesignating subsection (h) as sub-
21 section (i) and by inserting after subsection (g) the
22 following new subsection:

23 “(h) SPECIAL RULE FOR PARTNERSHIPS WHICH IN-
24 CORPORATE AND SUBSEQUENTLY REORGANIZE.—The
25 step transaction doctrine and any similar doctrine shall

1 not apply for purposes of determining whether the control
2 requirement of subsection (a) is met in any case in
3 which—

4 “(1) a partnership engaged in an active trade
5 or business transfers substantially all of the property
6 used in carrying on such trade or business to a cor-
7 poration which is not publicly traded, and

8 “(2) such corporation subsequently enters into
9 a reorganization under this chapter.”.

10 (2) EFFECTIVE DATE.—The amendment made
11 by this subsection shall apply to transactions after
12 December 31, 2004.

13 **SEC. 3. PARTNERSHIP INCOME ATTRIBUTABLE TO CAPITAL**
14 **EXCLUDED FROM NET EARNINGS FROM**
15 **SELF-EMPLOYMENT.**

16 (a) IN GENERAL.—Paragraph (13) of section
17 1402(a) of the Internal Revenue Code of 1986 is amended
18 to read as follows:

19 “(13) there shall be excluded the distributive
20 share of net income of a partner attributable to cap-
21 ital;”.

22 (b) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-
23 ITAL.—Section 1402 of such Code is amended by adding
24 at the end the following new subsection:

1 “(1) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-
2 ITAL.—

3 “(1) IN GENERAL.—For purposes of subsection
4 (a)(13), the following amounts shall be treated as in-
5 come attributable to capital—

6 “(A) the amount, if any, in excess of what
7 would constitute reasonable compensation for
8 services rendered by such partner to the part-
9 nership, and

10 “(B) an amount equal to a reasonable rate
11 of return on unreturned capital of the partner
12 determined as of the beginning of the taxable
13 year.

14 “(2) DEFINITIONS.—For purposes of paragraph
15 (1)—

16 “(A) UNRETURNED CAPITAL.—The term
17 ‘unreturned capital’ means the excess of the ag-
18 gregate amount of money and the fair market
19 value as of the date of contribution of other
20 consideration (net of liabilities) contributed by
21 the partner over the aggregate amount of
22 money and the fair market value as of the date
23 of distribution of other consideration (net of li-
24 abilities) distributed by the partnership to the
25 partner, increased or decreased for the part-

1 ner’s distributive share of all reportable items
2 as determined in section 702. If the partner ac-
3 quires a partnership interest and the partner-
4 ship makes an election under section 754, the
5 partner’s unreturned capital shall take into ac-
6 count appropriate adjustments under section
7 743.

8 “(B) REASONABLE RATE OF RETURN.—A
9 reasonable rate of return on unreturned capital
10 shall equal 150 percent (or such higher rate as
11 is established in regulations) of the highest ap-
12 plicable Federal rate, as determined under sec-
13 tion 1274(d)(1), at the beginning of the part-
14 nership’s taxable year.

15 “(3) REGULATIONS.—The Secretary shall pre-
16 scribe such regulations as may be necessary to carry
17 out the purposes of this subsection.”.

18 (c) EFFECTIVE DATE.—The amendments made by
19 this section shall apply with respect to services performed
20 in taxable years beginning after December 31, 2004.

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