

114TH CONGRESS  
2D SESSION

# S. 3181

To amend the Internal Revenue Code of 1986 to provide for S corporation reform, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

JULY 13, 2016

Mr. THUNE (for himself, Mr. CARDIN, and Mr. ROBERTS) 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 provide for S corporation reform, 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; REFERENCE; TABLE OF CON-**  
4 **TENTS.**

5 (a) SHORT TITLE.—This Act may be cited as the “S  
6 Corporation Modernization Act of 2016”.

7 (b) AMENDMENT OF 1986 CODE.—Except as other-  
8 wise expressly provided, whenever in this Act an amend-  
9 ment or repeal is expressed in terms of an amendment  
10 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 (c) TABLE OF CONTENTS.—The table of contents for  
 4 this Act is as follows:

- Sec. 1. Short title; reference; table of contents.
- Sec. 2. Expansion of qualifying beneficiaries of an electing small business trust.
- Sec. 3. Modifications to S corporation passive investment income rules.
- Sec. 4. Expansion of S corporation eligible shareholders to include IRAs.
- Sec. 5. Charitable contribution deduction for electing small business trusts.
- Sec. 6. Amortization of S corporation built-in gain amount upon death of share-  
holder.

5 **SEC. 2. EXPANSION OF QUALIFYING BENEFICIARIES OF AN**  
 6 **ELECTING SMALL BUSINESS TRUST.**

7 (a) NO LOOK-THROUGH FOR ELIGIBILITY PUR-  
 8 POSES.—Section 1361(c)(2)(B)(v) is amended by adding  
 9 at the end the following new sentence: “This clause shall  
 10 not apply for purposes of subsection (b)(1)(C).”.

11 (b) EFFECTIVE DATE.—The amendment made by  
 12 this section shall take effect on January 1, 2016.

13 **SEC. 3. MODIFICATIONS TO S CORPORATION PASSIVE IN-**  
 14 **VESTMENT INCOME RULES.**

15 (a) INCREASED PERCENTAGE LIMIT.—Section  
 16 1375(a)(2) is amended by striking “25 percent” and in-  
 17 serting “60 percent”.

18 (b) REPEAL OF EXCESSIVE PASSIVE INCOME AS A  
 19 TERMINATION EVENT.—Section 1362(d) is amended by  
 20 striking paragraph (3).

21 (c) CONFORMING AMENDMENTS.—

1           (1) Section 1375(b) is amended by striking  
2 paragraphs (3) and (4) and inserting the following  
3 new paragraph:

4           “(3) PASSIVE INVESTMENT INCOME DE-  
5 FINED.—

6           “(A) IN GENERAL.—Except as otherwise  
7 provided in this paragraph, the term ‘passive  
8 investment income’ means gross receipts de-  
9 rived from royalties, rents, dividends, interest,  
10 and annuities.

11           “(B) EXCEPTION FOR INTEREST ON  
12 NOTES FROM SALES OF INVENTORY.—The term  
13 ‘passive investment income’ shall not include in-  
14 terest on any obligation acquired in the ordi-  
15 nary course of the corporation’s trade or busi-  
16 ness from its sale of property described in sec-  
17 tion 1221(a)(1).

18           “(C) TREATMENT OF CERTAIN LENDING  
19 OR FINANCE COMPANIES.—If the S corporation  
20 meets the requirements of section 542(c)(6) for  
21 the taxable year, the term ‘passive investment  
22 income’ shall not include gross receipts for the  
23 taxable year which are derived directly from the  
24 active and regular conduct of a lending or fi-

1 nance business (as defined in section  
2 542(d)(1)).

3 “(D) TREATMENT OF CERTAIN DIVI-  
4 DENDS.—If an S corporation holds stock in a  
5 C corporation meeting the requirements of sec-  
6 tion 1504(a)(2), the term ‘passive investment  
7 income’ shall not include dividends from such C  
8 corporation to the extent such dividends are at-  
9 tributable to the earnings and profits of such C  
10 corporation derived from the active conduct of  
11 a trade or business.

12 “(E) EXCEPTION FOR BANKS, ETC.—In  
13 the case of a bank (as defined in section 581)  
14 or a depository institution holding company (as  
15 defined in section 3(w)(1) of the Federal De-  
16 posit Insurance Act (12 U.S.C. 1813(w)(1)),  
17 the term ‘passive investment income’ shall not  
18 include—

19 “(i) interest income earned by such  
20 bank or company, or

21 “(ii) dividends on assets required to  
22 be held by such bank or company, includ-  
23 ing stock in the Federal Reserve Bank, the  
24 Federal Home Loan Bank, or the Federal  
25 Agricultural Mortgage Bank or participa-

1                   tion certificates issued by a Federal Inter-  
2                   mediate Credit Bank.

3                   “(F) GROSS RECEIPTS FROM THE SALES  
4                   OF CERTAIN ASSETS.—For purposes of this  
5                   paragraph—

6                   “(i) CAPITAL ASSETS OTHER THAN  
7                   STOCK AND SECURITIES.—In the case of  
8                   dispositions of capital assets (other than  
9                   stock and securities), gross receipts from  
10                  such dispositions shall be taken into ac-  
11                  count only to the extent of capital gain net  
12                  income therefrom.

13                  “(ii) STOCK AND SECURITIES.—In the  
14                  case of sales or exchanges of stock or secu-  
15                  rities, gross receipts shall be taken into ac-  
16                  count only to the extent of the gain there-  
17                  from.

18                  “(G) COORDINATION WITH SECTION  
19                  1374.—The amount of passive investment in-  
20                  come shall be determined by not taking into ac-  
21                  count any recognized built-in gain or loss of the  
22                  S corporation for any taxable year in the rec-  
23                  ognition period. Terms used in the preceding  
24                  sentence shall have the same respective mean-  
25                  ings as when used in section 1374.”.



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

5           (b) SALE OF STOCK IN IRA RELATING TO S COR-  
 6 CORPORATION ELECTION EXEMPT FROM PROHIBITED  
 7 TRANSACTION RULES.—Section 4975(d)(16) is amend-  
 8 ed—

9                   (1) by striking subparagraphs (A) and (B) and  
 10                  by redesignating subparagraphs (C), (D), (E), and  
 11                  (F) as subparagraphs (A), (B), (C) and (D), respec-  
 12                  tively, and

13                  (2) by striking “such bank or company” in sub-  
 14                  paragraph (A) (as so redesignated) and inserting  
 15                  “the issuer of such stock”.

16           (c) EFFECTIVE DATE.—The amendments made by  
 17 this section shall take effect on January 1, 2016.

18 **SEC. 5. CHARITABLE CONTRIBUTION DEDUCTION FOR**  
 19 **ELECTING SMALL BUSINESS TRUSTS.**

20           (a) IN GENERAL.—Section 641(c)(2) is amended by  
 21 inserting after subparagraph (D) the following new sub-  
 22 paragraph:

23                   “(E)(i) Section 642(c) shall not apply.

24                   “(ii) For purposes of section 170(b)(1)(G),  
 25                  adjusted gross income shall be computed in the

1 same manner as in the case of an individual,  
2 except that the deductions for costs which are  
3 paid or incurred in connection with the admin-  
4 istration of the trust and which would not have  
5 been incurred if the property were not held in  
6 such trust shall be treated as allowable in arriv-  
7 ing at adjusted gross income.”.

8 (b) EFFECTIVE DATE.—The amendment made by  
9 this section shall apply to taxable years beginning after  
10 December 31, 2015.

11 **SEC. 6. AMORTIZATION OF S CORPORATION BUILT-IN GAIN**  
12 **AMOUNT UPON DEATH OF SHAREHOLDER.**

13 (a) IN GENERAL.—Part II of subchapter S of chapter  
14 1 is amended by adding at the end the following:

15 **“SEC. 1369. AMORTIZATION OF BUILT-IN GAIN AMOUNT**  
16 **UPON DEATH OF SHAREHOLDER.**

17 “(a) IN GENERAL.—A person holding stock in an  
18 electing S corporation the basis of which is determined  
19 under section 1014(a) (hereafter in this section referred  
20 to as the ‘shareholder’) shall be allowed a deduction with  
21 respect to the S corporation built-in gain amount. The  
22 amount of such deduction for any taxable year shall be  
23 determined by amortizing the S corporation built-in gain  
24 amount over the 15-year period beginning with the month  
25 which includes the applicable valuation date.

1       “(b) S CORPORATION BUILT-IN GAIN AMOUNT.—

2 For purposes of this section, the term ‘S corporation built-

3 in gain amount’ means the lesser of—

4           “(1) the excess (if any) of—

5               “(A) the basis of the stock referred to in

6 subsection (a) as determined under section

7 1014(a), over

8               “(B) the adjusted basis of such stock im-

9 mediately before the death of the decedent, or

10           “(2) the pro rata share (determined as of the

11 applicable valuation date) of—

12               “(A) the aggregate fair market value of all

13 property held by the S corporation which is of

14 a character subject to depreciation or amortiza-

15 tion, over

16               “(B) the aggregate adjusted basis of all

17 such property held by the S corporation as of

18 such date.

19       “(c) ELECTING S CORPORATION.—For purposes of

20 this section, the term ‘electing S corporation’ means, with

21 respect to any shareholder, any S corporation which elects

22 the application of this section with respect to such share-

23 holder at such time and in such form and manner as the

24 Secretary may prescribe.

1       “(d) APPLICABLE VALUATION DATE.—For purposes  
2 of this section, the term ‘applicable valuation date’  
3 means—

4           “(1) in the case of a decedent with respect to  
5 which the executor of the decedent’s estate elects the  
6 application of section 2032, the date 6 months after  
7 the decedent’s death, and

8           “(2) in the case of any other decedent, the date  
9 of the decedent’s death.

10       “(e) ACCELERATED DEDUCTION IN CASE OF DIS-  
11 POSITION OF S CORPORATION PROPERTY.—

12           “(1) IN GENERAL.—If the electing S corpora-  
13 tion disposes of any property which was taken into  
14 account under subsection (b)(2), then the deduction  
15 allowed under subsection (a) with respect to any  
16 stock, for the taxable year of the shareholder in  
17 which or with which the taxable year of the S cor-  
18 poration which includes the date of such disposition  
19 ends, shall (except as otherwise provided in this sec-  
20 tion) not be less than the lesser of—

21           “(A) the pro rata share of the gain recog-  
22 nized on such disposition, or

23           “(B) the amount determined under sub-  
24 section (b)(2) by only taking into account such  
25 property.

1           “(2) OVERALL ALLOWANCE NOT INCREASED.—

2           No deduction shall be allowed under subsection (a)  
3           with respect to any stock for any taxable year to the  
4           extent that such deduction (when added to the de-  
5           ductions so allowed for all prior taxable years) ex-  
6           ceeds the S corporation built-in gain amount with  
7           respect to such stock.

8           “(f) RECHARACTERIZATION OF GAINS AS ORDINARY  
9 INCOME TO EXTENT OF DEDUCTION.—If—

10           “(1) stock of an S corporation with respect to  
11           which a deduction was allowed under this section, or

12           “(2) property which was taken into account  
13           under subsection (b)(2) with respect to such stock,

14 is disposed of at a gain (determined without regard to

15 whether or not such gain is recognized and reduced by

16 any amount of gain which is treated as ordinary income

17 under any other provision of this subtitle), the amount of

18 such gain (or the shareholder’s pro rata share of such gain

19 in the case of property described in paragraph (2)) shall

20 be treated as gain which is ordinary income (and shall be

21 recognized notwithstanding any other provision of this

22 subtitle) to the extent of the excess of the aggregate de-

23 ductions allowable under this section with respect to such

24 stock for the taxable year of such disposition and all prior

1 taxable years over the amounts taken into account under  
2 this subsection for all prior taxable years.

3 “(g) TERMINATION OF AMORTIZATION.—No deduc-  
4 tion shall be allowed under subsection (a) with respect to  
5 any stock in an electing S corporation with respect to any  
6 period beginning after the earlier of—

7 “(1) the date on which the corporation’s elec-  
8 tion under section 1362 terminates, or

9 “(2) the date on which the shareholder trans-  
10 fers such stock to any other person.

11 “(h) TREATMENT OF CERTAIN TRANSFERS.—

12 “(1) DISTRIBUTIONS FROM ESTATES OR  
13 TRUSTS.—Notwithstanding any other provision of  
14 this section, in the case of a distribution of stock  
15 from an estate or trust to a beneficiary, the bene-  
16 ficiary (and not the estate or trust) shall be treated  
17 as the shareholder to which this section applies with  
18 respect to periods after such distribution. In the  
19 case of a distribution of stock from an estate or  
20 trust to an electing small business trust (as defined  
21 in section 1361(e)), such electing small business  
22 trust shall be treated as a beneficiary for purposes  
23 of the preceding sentence.

24 “(2) CERTAIN TRANSFERS INVOLVING  
25 SPOUSES.—Notwithstanding any other provision of

1 this section, in the case of a transfer described in  
2 section 1041, the transferee (and not the transferor)  
3 shall be treated as the shareholder to which this sec-  
4 tion applies with respect to periods after such trans-  
5 fer.

6 “(i) TREATMENT OF INCOME IN RESPECT OF THE  
7 DECEDENT.—

8 “(1) ADJUSTMENT TO BUILT-IN GAIN OF PROP-  
9 erty HELD BY S CORPORATION.—For purposes of  
10 subsection (b)(2), the fair market value of any prop-  
11 erty taken into account under subparagraph (A)  
12 thereof shall be decreased by any amount of income  
13 in respect of the decedent with respect to such prop-  
14 erty to which section 691 applies. For purposes of  
15 subsection (e)(1)(A), the gain recognized on the dis-  
16 position of such property shall be reduced by such  
17 amount.

18 “(2) ADJUSTMENT TO BASIS OF S CORPORA-  
19 tion STOCK.—For adjustment to basis of S corpora-  
20 tion stock, see section 1367(b)(4)(B).

21 “(j) REPORTING.—Except as otherwise provided by  
22 the Secretary, for purposes of section 6037, the amounts  
23 determined under subsections (b)(2), (e)(1), and (f)(2)  
24 shall be treated as items of the corporation and the pro

1 rata share determined under such subsection shall be fur-  
2 nished to the shareholder under section 6037(b).”.

3 (b) ADJUSTMENT TO BASIS OF STOCK.—

4 (1) IN GENERAL.—Section 1367(a)(2) is  
5 amended by striking “and” at the end of subpara-  
6 graph (D), by striking the period at the end of sub-  
7 paragraph (E) and inserting “, and”, and by insert-  
8 ing after subparagraph (E) the following new sub-  
9 paragraph:

10 “(F) the amount of the shareholder’s de-  
11 duction under section 1369.”.

12 (2) ADJUSTMENT NOT TAKEN INTO ACCOUNT  
13 IN DETERMINING TREATMENT OF DISTRIBUTIONS.—  
14 Section 1368 is amended—

15 (A) in subsection (d)(1), by inserting  
16 “(other than subsection (a)(2)(F) thereof)”  
17 after “section 1367”, and

18 (B) in subsection (e)(1)(A)—

19 (i) by striking “this title and the  
20 phrase” and inserting “this title, the  
21 phrase”, and

22 (ii) by inserting “, and no adjustment  
23 shall be made under section  
24 1367(a)(2)(F)” after “section 1367(a)(2)”.

1           (c) CLERICAL AMENDMENT.—The table of sections  
2 for part II of subchapter S of chapter 1 is amended by  
3 adding at the end the following new item:

“Sec. 1369. Amortization of built-in gain amount upon death of shareholder.”.

4           (d) EFFECTIVE DATE.—The amendments made by  
5 this section shall apply to with respect to decedents dying  
6 after the date of the enactment of this Act, in taxable  
7 years ending after such date.

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