

115TH CONGRESS
1ST SESSION

S. 711

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

IN THE SENATE OF THE UNITED STATES

MARCH 23, 2017

Mr. THUNE (for himself, Mr. CARDIN, and Mr. ROBERTS) introduced the following bill; which was read twice and referred to the Committee on Finance

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 2017”.

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.
- Sec. 7. Extension of time for making S corporation elections.

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, 2018.

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 (2)(A) Section 26(b)(2)(J) is amended by strik-
2 ing “25 percent” and inserting “60 percent”.

3 (B) Section 1375(b)(1)(A)(i) is amended by
4 striking “25 percent” and inserting “60 percent”.

5 (C) The heading for section 1375 is amended
6 by striking “**25 PERCENT**” and inserting “**60 PER-**
7 **CENT**”.

8 (D) The item relating to section 1375 in the
9 table of sections for part III of subchapter S of
10 chapter 1 is amended by striking “25 percent” and
11 inserting “60 percent”.

12 (3) Section 1042(c)(4)(A)(i) is amended by
13 striking “section 1362(d)(3)(C)” and inserting “sec-
14 tion 1375(b)(3)”.

15 (4) Section 1362(f)(1)(B) is amended by strik-
16 ing “paragraph (2) or (3) of subsection (d)” and in-
17 serting “subsection (d)(2)”.

18 (d) **EFFECTIVE DATE.**—The amendments made by
19 this section shall apply to taxable years beginning after
20 December 31, 2017.

21 **SEC. 4. EXPANSION OF S CORPORATION ELIGIBLE SHARE-**
22 **HOLDERS TO INCLUDE IRAS.**

23 (a) **IN GENERAL.**—Section 1361(c)(2)(A)(vi) is
24 amended to read as follows:

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, 2018.

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, 2017.

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.

19 “(2) CERTAIN TRANSFERS INVOLVING
20 SPOUSES.—Notwithstanding any other provision of
21 this section, in the case of a transfer described in
22 section 1041, the transferee (and not the transferor)
23 shall be treated as the shareholder to which this sec-
24 tion applies with respect to periods after such trans-
25 fer.

1 “(i) TREATMENT OF INCOME IN RESPECT OF THE
2 DECEDENT.—

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

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

16 “(j) REPORTING.—Except as otherwise provided by
17 the Secretary, for purposes of section 6037, the amounts
18 determined under subsections (b)(2), (e)(1), and (f)(2)
19 shall be treated as items of the corporation and the pro
20 rata share determined under such subsection shall be fur-
21 nished to the shareholder under section 6037(b).”.

22 (b) ADJUSTMENT TO BASIS OF STOCK.—

23 (1) IN GENERAL.—Section 1367(a)(2) is
24 amended by striking “and” at the end of subpara-
25 graph (D), by striking the period at the end of sub-

1 paragraph (E) and inserting “, and”, and by insert-
 2 ing after subparagraph (E) the following new sub-
 3 paragraph:

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

6 (2) ADJUSTMENT NOT TAKEN INTO ACCOUNT
 7 IN DETERMINING TREATMENT OF DISTRIBUTIONS.—

8 Section 1368 is amended—

9 (A) in subsection (d)(1), by inserting
 10 “(other than subsection (a)(2)(F) thereof)”
 11 after “section 1367”, and

12 (B) in subsection (e)(1)(A)—

13 (i) by striking “this title and the
 14 phrase” and inserting “this title, the
 15 phrase”, and

16 (ii) by inserting “, and no adjustment
 17 shall be made under section
 18 1367(a)(2)(F)” after “section 1367(a)(2)”.

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

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

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

1 **SEC. 7. EXTENSION OF TIME FOR MAKING S CORPORATION**
2 **ELECTIONS.**

3 (a) IN GENERAL.—Subsection (b) of section 1362 is
4 amended to read as follows:

5 “(b) WHEN MADE.—

6 “(1) IN GENERAL.—An election under sub-
7 section (a) may be made by a small business cor-
8 poration for any taxable year not later than the due
9 date for filing the return of the S corporation for
10 such taxable year (including extensions).

11 “(2) CERTAIN ELECTIONS TREATED AS MADE
12 FOR NEXT TAXABLE YEAR.—If—

13 “(A) an election under subsection (a) is
14 made for any taxable year within the period de-
15 scribed in paragraph (1), but

16 “(B) either—

17 “(i) on 1 or more days in such taxable
18 year and before the day on which the elec-
19 tion was made the corporation did not
20 meet the requirements of subsection (b) of
21 section 1361, or

22 “(ii) 1 or more of the persons who
23 held stock in the corporation during such
24 taxable year and before the election was
25 made did not consent to the election,

1 then such election shall be treated as made for
2 the following taxable year.

3 “(3) AUTHORITY TO TREAT LATE ELECTIONS,
4 ETC., AS TIMELY.—If—

5 “(A) an election under subsection (a) is
6 made for any taxable year after the date pre-
7 scribed by this subsection for making such elec-
8 tion for such taxable year or no such election is
9 made for any taxable year, and

10 “(B) the Secretary determines that there
11 was reasonable cause for the failure to timely
12 make such election,

13 the Secretary may treat such an election as timely
14 made for such taxable year.

15 “(4) ELECTION ON TIMELY FILED RETURNS.—
16 Except as otherwise provided by the Secretary, an
17 election under subsection (a) for any taxable year
18 may be made on a timely filed return of the S cor-
19 poration for such taxable year.

20 “(5) SECRETARIAL AUTHORITY.—The Secretary
21 may prescribe such regulations, rules, or other guid-
22 ance as may be necessary or appropriate for pur-
23 poses of applying this subsection.”.

24 (b) COORDINATION WITH CERTAIN OTHER PROVI-
25 SIONS.—

1 (1) QUALIFIED SUBCHAPTER S SUBSIDI-
2 ARIES.—Section 1361(b)(3)(B) is amended by add-
3 ing at the end the following flush sentence:

4 “Rules similar to the rules of section 1362(b)
5 shall apply with respect to any election under
6 clause (ii).”.

7 (2) QUALIFIED SUBCHAPTER S TRUSTS.—Sec-
8 tion 1361(d)(2) is amended by striking subpara-
9 graph (D).

10 (c) REVOCATIONS.—Paragraph (1) of section
11 1362(d) is amended—

12 (1) by striking “subparagraph (D)” in subpara-
13 graph (C) and inserting “subparagraphs (D) and
14 (E)”, and

15 (2) by adding at the end the following new sub-
16 paragraph:

17 “(E) AUTHORITY TO TREAT LATE REVOCATIONS AS
18 TIMELY.—If—

19 “ (i) a revocation under subparagraph
20 (A) is made for any taxable year after the
21 date prescribed by this paragraph for mak-
22 ing such revocation for such taxable year
23 or no such revocation is made for any tax-
24 able year, and

1 “(ii) the Secretary determines that
2 there was reasonable cause for the failure
3 to timely make such revocation,
4 the Secretary may treat such a revocation as
5 timely made for such taxable year.”.

6 (d) EFFECTIVE DATE.—

7 (1) IN GENERAL.—Except as otherwise pro-
8 vided in this subsection, the amendments made by
9 this section shall apply to elections for taxable years
10 beginning after December 31, 2017.

11 (2) REVOCATIONS.—The amendments made by
12 subsection (c) shall apply to revocations after De-
13 cember 31, 2017.

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