116TH CONGRESS
1ST SESSION

S.

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

Mr. THUNE introduced the following bill; which was read twice and referred to the Committee on ____________

A BILL

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

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; REFERENCE.

(a) SHORT TITLE.—This Act may be cited as the “S Corporation Modernization Act of 2019”.

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference
shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

SEC. 2. MODIFICATIONS TO S CORPORATION PASSIVE INVESTMENT INCOME RULES.

(a) INCREASED PERCENTAGE LIMIT.—Section 1375(a)(2) is amended by striking "25 percent" and inserting "60 percent".

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

(c) CONFORMING AMENDMENTS.—

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

"(3) PASSIVE INVESTMENT INCOME DEFINED.—"

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term ‘passive investment income’ means gross receipts derived from royalties, rents, dividends, interest, and annuities.

"(B) EXCEPTION FOR INTEREST ON NOTES FROM SALES OF INVENTORY.—The term ‘passive investment income’ shall not include interest on any obligation acquired in the ordi-
nary course of the corporation’s trade or business from its sale of property described in section 1221(a)(1).

“(C) Treatment of Certain Lending or Finance Companies.—If the S corporation meets the requirements of section 542(c)(6) for the taxable year, the term ‘passive investment income’ shall not include gross receipts for the taxable year which are derived directly from the active and regular conduct of a lending or finance business (as defined in section 542(d)(1)).

“(D) Treatment of Certain Dividends.—If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term ‘passive investment income’ shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business.

“(E) Exception for Banks, Etc.—In the case of a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal De-
the term ‘passive investment income’ shall not include—

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

“(ii) dividends on assets required to be held by such bank or company, including stock in the Federal Reserve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.

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

“(i) CAPITAL ASSETS OTHER THAN STOCK AND SECURITIES.—In the case of dispositions of capital assets (other than stock and securities), gross receipts from such dispositions shall be taken into account only to the extent of capital gain net income therefrom.

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

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

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

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

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

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

(3) Section 1042(c)(4)(A)(i) is amended by
striking “section 1362(d)(3)(C)” and inserting “sec-
tion 1375(b)(3)”.
(4) Section 1362(f)(1)(B) is amended by striking “paragraph (2) or (3) of subsection (d)” and inserting “subsection (d)(2)”.  

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2019.

SEC. 3. EXPANSION OF S CORPORATION ELIGIBLE SHAREHOLDERS TO INCLUDE IRAS.

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

“(vi) A trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A.”.

(b) SALE OF STOCK IN IRA RELATING TO S CORPORATION ELECTION EXEMPT FROM PROHIBITED TRANSACTION RULES.—Section 4975(d)(16) is amended—

(1) by striking subparagraphs (A) and (B) and by redesignating subparagraphs (C), (D), (E), and (F) as subparagraphs (A), (B), (C), and (D), respectively, and

(2) by striking “such bank or company” in subparagraph (A) (as so redesignated) and inserting “the issuer of such stock”.


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(c) **Effective Date.**—The amendments made by this section shall take effect on January 1, 2020.

**SEC. 4. TREATMENT OF S CORPORATION BUILT-IN GAIN AMOUNT UPON DEATH OF SHAREHOLDER.**

(a) **In General.**—Part II of subchapter S of chapter 1 is amended by adding at the end the following:

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

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

“(b) **S Corporation Built-In Gain Amount.**—For purposes of this section, the term ‘S corporation built-in gain amount’ means the lesser of—

“(1) the excess (if any) of—

“(A) the basis of the stock referred to in subsection (a) as determined under section 1014(a), over
“(B) the adjusted basis of such stock immediately before the death of the decedent, or
“(2) the pro rata share (determined as of the applicable valuation date) of—
“(A) the aggregate fair market value of all property held by the S corporation which is of a character subject to depreciation or amortization, over
“(B) the aggregate adjusted basis of all such property held by the S corporation as of such date.
“(c) ELECTING S CORPORATION.—For purposes of this section, the term ‘electing S corporation’ means, with respect to any shareholder, any S corporation which elects the application of this section with respect to such shareholder at such time and in such form and manner as the Secretary may prescribe.
“(d) APPLICABLE VALUATION DATE.—For purposes of this section, the term ‘applicable valuation date’ means—
“(1) in the case of a decedent with respect to which the executor of the decedent’s estate elects the application of section 2032, the date 6 months after the decedent’s death, and
“(2) in the case of any other decedent, the date of the decedent’s death.

“(e) ACCELERATED DEDUCTION IN CASE OF DISPOSITION OF S CORPORATION PROPERTY.—

“(1) IN GENERAL.—If the electing S corporation disposes of any property which was taken into account under subsection (b)(2), then the deduction allowed under subsection (a) with respect to any stock, for the taxable year of the shareholder in which or with which the taxable year of the S corporation which includes the date of such disposition ends, shall (except as otherwise provided in this section) not be less than the lesser of—

“(A) the pro rata share of the gain recognized on such disposition, or

“(B) the amount determined under subsection (b)(2) by only taking into account such property.

“(2) OVERALL ALLOWANCE NOT INCREASED.—

No deduction shall be allowed under subsection (a) with respect to any stock for any taxable year to the extent that such deduction (when added to the deductions so allowed for all prior taxable years) exceeds the S corporation built-in gain amount with respect to such stock.
“(f) Recharacterization of Gains as Ordinary Income to Extent of Deduction.—If—

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

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

is disposed of at a gain (determined without regard to whether or not such gain is recognized and reduced by any amount of gain which is treated as ordinary income under any other provision of this subtitle), the amount of such gain (or the shareholder’s pro rata share of such gain in the case of property described in paragraph (2)) shall be treated as gain which is ordinary income (and shall be recognized notwithstanding any other provision of this subtitle) to the extent of the excess of the aggregate deductions allowable under this section with respect to such stock for the taxable year of such disposition and all prior taxable years over the amounts taken into account under this subsection for all prior taxable years.

“(g) Termination of Amortization.—No deduction shall be allowed under subsection (a) with respect to any stock in an electing S corporation with respect to any period beginning after the earlier of—

“(1) the date on which the corporation’s election under section 1362 terminates, or
“(2) the date on which the shareholder transfers such stock to any other person.

“(h) TREATMENT OF CERTAIN TRANSFERS.—

“(1) DISTRIBUTIONS FROM ESTATES OR TRUSTS.—Notwithstanding any other provision of this section, in the case of a distribution of stock from an estate or trust to a beneficiary, the beneficiary (and not the estate or trust) shall be treated as the shareholder to which this section applies with respect to periods after such distribution.

“(2) CERTAIN TRANSFERS INVOLVING SPOUSES.—Notwithstanding any other provision of this section, in the case of a transfer described in section 1041, the transferee (and not the transferor) shall be treated as the shareholder to which this section applies with respect to periods after such transfer.

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

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

“(2) Adjustment to Basis of S Corporation Stock.—For adjustment to basis of S corporation stock, see section 1367(b)(4)(B).

“(j) Reporting.—Except as otherwise provided by the Secretary, for purposes of section 6037, the amounts determined under subsections (b)(2), (e)(1), and (f)(2) shall be treated as items of the corporation and the prorata share determined under such subsection shall be furnished to the shareholder under section 6037(b).”.

(b) Adjustment to Basis of Stock.—

(1) In General.—Section 1367(a)(2) is amended by striking “and” at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting “, and”, and by inserting after subparagraph (E) the following new subparagraph:

“(F) the amount of the shareholder’s deduction allowable under section 1369.”.

(2) Adjustment Not Taken into Account in Determining Treatment of Distributions.—
(A) in subsection (d)(1), by inserting "(other than subsection (a)(2)(F) thereof)" after "section 1367", and

(B) in subsection (e)(1)(A)—

(i) by striking "this title and the phrase" and inserting "this title, the phrase", and

(ii) by inserting " , and no adjustment shall be made under section 1367(a)(2)(F)" after "section 1367(a)(2)".

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

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

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

SEC. 5. REVOCATIONS OF S CORPORATION ELECTIONS.

(a) REVOCATIONS.—Paragraph (1) of section 1362(d) is amended—

(1) by striking "subparagraph (D)" in subparagraph (C) and inserting "subparagraphs (D) and (E)"; and

(2) by adding at the end the following new sub-

paragraph:
“(E) Authority to treat late revocations as timely.—If—

“(i) a revocation under subparagraph (A) is made for any taxable year after the date prescribed by this paragraph for making such revocation for such taxable year or no such revocation is made for any taxable year, and

“(ii) the Secretary determines that there was reasonable cause for the failure to timely make such revocation,

the Secretary may treat such a revocation as timely made for such taxable year.”.

(b) Effective Date.—The amendments made by this section shall apply to revocations after December 31, 2019.