

[WAYS AND MEANS DISCUSSION DRAFT]

MARCH 12, 2013

113TH CONGRESS
1ST SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to provide for comprehensive income tax reform.

IN THE HOUSE OF REPRESENTATIVES

M. _____ introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to provide for comprehensive income tax reform.

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; ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Tax Reform Act of 2013”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment

1 to, or repeal of, a section or other provision, the reference
2 shall be considered to be made to a section or other provi-
3 sion of the Internal Revenue Code of 1986.

4 (c) TABLE OF CONTENTS.—The table of contents of
5 this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—TAX REFORM FOR INDIVIDUALS

Sec. 101. [to be provided].

TITLE II—TAX REFORM FOR BUSINESSES

Subtitle A—Corporate Income Tax Rate Reduction

Sec. 201. [to be provided].

Subtitle B—Tax Reform for Small Businesses

PART 1—GENERAL PROVISIONS

- Sec. 211. Expensing certain depreciable business assets for small business.
- Sec. 212. Limitation on use of cash method of accounting.
- Sec. 213. Repeal of required use of accrual method for corporations engaged in farming.
- Sec. 214. Modification of rules for capitalization and inclusion in inventory costs of certain expenses.
- Sec. 215. Unification of deduction for start-up and organizational expenditures.

PART 2—TAX RETURN DUE DATE SIMPLIFICATION

- Sec. 221. New due date for partnership form 1065, S corporation form 1120S, and C corporation form 1120.
- Sec. 222. Modification of due dates by regulation.
- Sec. 223. Corporations permitted statutory automatic 6-month extension of income tax returns.

Subtitle C—[Option 1] Passthrough Entities

PART 1—[OPTION 1] S CORPORATIONS

- Sec. 231. Reduced recognition period for built-in gains made permanent.
- Sec. 232. Modifications to S corporation passive investment income rules.
- Sec. 233. Expansion of qualifying beneficiaries of an electing small business trust.
- Sec. 234. Charitable contribution deduction for electing small business trusts.
- Sec. 235. Permanent rule regarding basis adjustment to stock of S corporations making charitable contributions of property.
- Sec. 236. Extension of time for making S corporation elections.
- Sec. 237. Relocation of C corporation definition.

PART 2—[OPTION 1] PARTNERSHIPS

- Sec. 241. Repeal of rules relating to guaranteed payments and liquidating distributions.
- Sec. 242. Mandatory adjustments to basis of partnership property in case of transfer of partnership interests.
- Sec. 243. Mandatory adjustments to basis of undistributed partnership property.
- Sec. 244. Corresponding adjustments to basis of properties held by partnership where partnership basis adjusted.
- Sec. 245. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss.
- Sec. 246. Revisions related to unrealized receivables and inventory items.
- Sec. 247. Repeal of time limitation on taxing precontribution gain.

Subtitle C—[Option 2] Unified Rules for Passthroughs

- Sec. 231. Unified rules for passthroughs.

Subtitle D—Other Business Tax Reforms

- Sec. 2____. **【to be provided】**.

TITLE III—PARTICIPATION EXEMPTION SYSTEM FOR THE
TAXATION OF FOREIGN INCOME

- Sec. 301. **【to be provided】**.

TITLE IV—OTHER REFORMS

- Sec. 401. **【to be provided】**.

1 **TITLE I—TAX REFORM FOR**
2 **INDIVIDUALS**

3 **SEC. 101. [TO BE PROVIDED].**

4 **TITLE II—TAX REFORM FOR**
5 **BUSINESSES**

6 **Subtitle A—Corporate Income Tax**
7 **Rate Reduction**

8 **SEC. 201. [TO BE PROVIDED].**

9 **Subtitle B—Tax Reform for Small**
10 **Businesses**

11 **PART 1—GENERAL PROVISIONS**

12 **SEC. 211. EXPENSING CERTAIN DEPRECIABLE BUSINESS**
13 **ASSETS FOR SMALL BUSINESS.**

14 (a) IN GENERAL.—

15 (1) DOLLAR LIMITATION.—Paragraph (1) of
16 section 179(b) is amended by striking “shall not ex-
17 ceed—” and all that follows and inserting “shall not
18 exceed \$250,000.”.

19 (2) REDUCTION IN LIMITATION.—Paragraph
20 (2) of section 179(b) is amended by striking “ex-
21 ceeds—” and all that follows and inserting “exceeds
22 \$800,000.”.

23 (b) COMPUTER SOFTWARE.—Clause (ii) of section
24 179(d)(1)(A) is amended by striking “and before 2014”.

1 (c) ELECTION.—Paragraph (2) of section 179(c) is
2 amended by striking “may not be revoked” and all that
3 follows through “and before 2014”.

4 (d) QUALIFIED REAL PROPERTY.—Section 179(f) is
5 amended—

6 (1) by striking “beginning in 2010, 2011, 2012,
7 or 2013” in paragraph (1), and

8 (2) by striking paragraph (4).

9 (e) INFLATION ADJUSTMENT.—Subsection (b) of sec-
10 tion 179 is amended by adding at the end the following
11 new paragraph:

12 “(6) INFLATION ADJUSTMENT.—

13 “(A) IN GENERAL.—In the case of any
14 taxable year beginning after 2014, the dollar
15 amounts in paragraphs (1) and (2) shall each
16 be increased by an amount equal to—

17 “(i) such dollar amount, multiplied by

18 “(ii) the cost-of-living adjustment de-
19 termined under section 1(f)(3) for the cal-
20 endar year in which the taxable year be-
21 gins, by substituting ‘2013’ for ‘1992’ in
22 subparagraph (B) thereof.

23 “(B) ROUNDING.—The amount of any in-
24 crease under subparagraph (A) shall be round-
25 ed to the nearest multiple of \$10,000.”.

1 (f) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years beginning after
3 December 31, 2013.

4 **SEC. 212. LIMITATION ON USE OF CASH METHOD OF AC-**
5 **COUNTING.**

6 (a) IN GENERAL.—Section 448 is amended to read
7 as follows:

8 **“SEC. 448. LIMITATION ON USE OF CASH METHOD OF AC-**
9 **COUNTING.**

10 “(a) IN GENERAL.—The cash receipts and disburse-
11 ments method of accounting may only be used by—

12 “(1) a natural person, and

13 “(2) any other taxpayer which meets the gross
14 receipts test of subsection (b) for the taxable year.

15 Such method may not be used by a tax shelter (as defined
16 in subsection (c)).

17 “(b) GROSS RECEIPTS TEST.—For purposes of this
18 section—

19 “(1) IN GENERAL.—A taxpayer meets the gross
20 receipts test of this subsection for any taxable year
21 if the average annual gross receipts of such taxpayer
22 for the 3-taxable-year period ending with the taxable
23 year which precedes such taxable year does not ex-
24 ceed \$10,000,000.

1 “(2) AGGREGATION RULES.— All persons treat-
2 ed as a single employer under subsection (a) or (b)
3 of section 52 or subsection (m) or (o) of section 414
4 shall be treated as one person for purposes of para-
5 graph (1).

6 “(3) SPECIAL RULES.—For purposes of this
7 subsection—

8 “(A) NOT IN EXISTENCE FOR ENTIRE 3-
9 YEAR PERIOD.—If the taxpayer was not in ex-
10 istence for the entire 3-year period referred to
11 in paragraph (1), such paragraph shall be ap-
12 plied on the basis of the period during which
13 such taxpayer (or trade or business) was in ex-
14 istence.

15 “(B) SHORT TAXABLE YEARS.—Gross re-
16 ceipts for any taxable year of less than 12
17 months shall be annualized by multiplying the
18 gross receipts for the short period by 12 and di-
19 viding the result by the number of months in
20 the short period.

21 “(C) GROSS RECEIPTS.—Gross receipts for
22 any taxable year shall be reduced by returns
23 and allowances made during such year.

24 “(D) TREATMENT OF PREDECESSORS.—
25 Any reference in this subsection to a taxpayer

1 shall include a reference to any predecessor of
2 such taxpayer.

3 “(c) TAX SHELTER DEFINED.—For purposes of this
4 section, the term ‘tax shelter’ has the meaning given such
5 term by section 461(i)(3) (determined after application of
6 paragraph (4) thereof). An S corporation shall not be
7 treated as a tax shelter for purposes of this section merely
8 by reason of being required to file a notice of exemption
9 from registration with a State agency described in section
10 461(i)(3)(A), but only if there is a requirement applicable
11 to all corporations offering securities for sale in the State
12 that to be exempt from such registration the corporation
13 must file such a notice.

14 “(d) SPECIAL RULES.—For purposes of this sec-
15 tion—

16 “(1) COORDINATION WITH SECTION 481.—In
17 the case of any taxpayer required by this section to
18 change its method of accounting for any taxable
19 year—

20 “(A) such change shall be treated as initi-
21 ated by the taxpayer, and

22 “(B) such change shall be treated as made
23 with the consent of the Secretary.

24 “(2) USE OF RELATED PARTIES, ETC.—The
25 Secretary shall prescribe such regulations as may be

1 necessary to prevent the use of related parties, pass-
2 thru entities, or intermediaries to avoid the applica-
3 tion of this section.”.

4 (b) CONFORMING AMENDMENTS.—

5 (1) Section 446(c)(1) is amended by inserting
6 “to the extent provided in section 448,” before “the
7 cash receipts”.

8 (2) Section 451 is amended by adding at the
9 end the following new subsection:

10 “(j) SPECIAL RULE FOR LOSSES OF CERTAIN SERV-
11 ICE PROVIDERS ON ACCRUAL METHOD OF ACCOUNT-
12 ING.—

13 “(1) IN GENERAL.—In the case of any person
14 using an accrual method of accounting with respect
15 to amounts to be received for the performance of
16 services by such person, such person shall not be re-
17 quired to accrue any portion of such amounts which
18 (on the basis of such person’s experience) will not be
19 collected if such services are in the fields of health,
20 law, engineering, architecture, accounting, actuarial
21 science, performing arts, consulting, or any other
22 field identified by the Secretary for purposes of this
23 subsection.

24 “(2) EXCEPTION.—Paragraph (1) shall not
25 apply to any amount if interest is required to be

1 paid on such amount or there is any penalty for fail-
2 ure to timely pay such amount.

3 “(3) REGULATIONS.—The Secretary shall pre-
4 scribe regulations to permit taxpayers to determine
5 amounts referred to in paragraph (1) using com-
6 putations or formulas which, based on experience,
7 accurately reflect the amount of income that will not
8 be collected by such person. A taxpayer may adopt,
9 or request consent of the Secretary to change to, a
10 computation or formula that clearly reflects the tax-
11 payer’s experience. A request under the preceding
12 sentence shall be approved if such computation or
13 formula clearly reflects the taxpayer’s experience.”.

14 (c) EFFECTIVE DATE.—

15 (1) IN GENERAL.—The amendments made by
16 this section shall apply to taxable years beginning
17 after December 31, 2013.

18 (2) CHANGE IN METHOD OF ACCOUNTING.—In
19 the case of any change in method of accounting for
20 the taxpayer’s first taxable year beginning after De-
21 cember 31, 2013, which—

22 (A) is required by the amendments made
23 by this section, or

24 (B) which was prohibited under section
25 481 of the Internal Revenue Code of 1986 prior

1 to such amendments and is permitted under
2 such section after such amendments,
3 such change shall be treated as initiated by the tax-
4 payer and made with the consent of the Secretary of
5 the Treasury.

6 **SEC. 213. REPEAL OF REQUIRED USE OF ACCRUAL METHOD**
7 **FOR CORPORATIONS ENGAGED IN FARMING.**

8 (a) IN GENERAL.—Part II of subchapter E of chap-
9 ter 1 is amended by striking section 447 (and by striking
10 the item relating to such section in the table of sections
11 for such part).

12 (b) CONFORMING AMENDMENTS.—

13 (1) Section 4972(c)(6) is amended in by strik-
14 ing “section 447(e)(1)” and inserting “section
15 354(a)(2)(D)(iii)(I)”.

16 (1) Section 354(a)(2) is amended by striking
17 subparagraph (C) and by inserting the following new
18 subparagraphs:

19 “(C) NONQUALIFIED PREFERRED
20 STOCK.—Nonqualified preferred stock (as de-
21 fined in section 351(g)(2)) received in exchange
22 for stock other than nonqualified preferred
23 stock (as so defined) shall not be treated as
24 stock or securities.

1 “(D) RECAPITALIZATIONS OF FAMILY-
2 OWNED CORPORATIONS.—

3 “(i) IN GENERAL.—Subparagraph (C)
4 shall not apply in the case of a recapital-
5 ization under section 368(a)(1)(E) of a
6 family-owned corporation.

7 “(i) FAMILY-OWNED CORPORATION.—
8 For purposes of this subparagraph, except
9 as provided in regulations, the term ‘fam-
10 ily-owned corporation’ means any corpora-
11 tion which is described in clause (ii)
12 throughout the 8-year period beginning on
13 the date which is 5 years before the date
14 of the recapitalization. For purposes of the
15 preceding sentence, stock shall not be
16 treated as owned by a family member dur-
17 ing any period described in section
18 355(d)(6)(B).

19 “(ii) CORPORATION DESCRIBED.—A
20 corporation is described in this clause if at
21 least 50 percent of the total combined vot-
22 ing power of all classes of stock entitled to
23 vote, and at least 50 percent of all other
24 classes of stock of the corporation, are
25 owned by members of the same family.

1 “(iii) MEMBERS OF THE SAME FAM-
2 ILY.—For purposes of this subpara-
3 graph—

4 “(I) the members of the same
5 family are an individual, such individ-
6 ual’s brothers and sisters, the broth-
7 ers and sisters of such individual’s
8 parents and grandparents, the ances-
9 tors and lineal descendants of any of
10 the foregoing, a spouse of any of the
11 foregoing, and the estate of any of the
12 foregoing,

13 “(II) stock owned, directly or in-
14 directly, by or for a partnership or
15 trust shall be treated as owned pro-
16 portionately by its partners or bene-
17 ficiaries, and

18 “(III) if 50 percent or more in
19 value of the stock in a corporation
20 (hereinafter in this paragraph referred
21 to as ‘first corporation’) is owned, di-
22 rectly or through subclause (II), by or
23 for members of the same family, such
24 members shall be considered as own-
25 ing each class of stock in a second

1 corporation (or a wholly owned sub-
2 sidiary of such second corporation)
3 owned, directly or indirectly, by or for
4 the first corporation, in that propor-
5 tion which the value of the stock in
6 the first corporation which such mem-
7 bers so own bears to the value of all
8 the stock in the first corporation.

9 For purposes of subclause (I), individuals
10 related by the half blood or by legal adop-
11 tion shall be treated as if they were related
12 by the whole blood.”.

13 (c) EFFECTIVE DATE.—

14 (1) IN GENERAL.—The amendments made by
15 this section shall apply to taxable years beginning
16 after December 31, 2013.

17 (2) CHANGE IN METHOD OF ACCOUNTING.—In
18 the case of any taxpayer required by the amend-
19 ments made by this section to change its method of
20 accounting for its first taxable year beginning after
21 December 31, 2013—

22 (A) such change shall be treated as initi-
23 ated by the taxpayer, and

1 (B) such change shall be treated as made
2 with the consent of the Secretary of the Treas-
3 ury.

4 **SEC. 214. MODIFICATION OF RULES FOR CAPITALIZATION**
5 **AND INCLUSION IN INVENTORY COSTS OF**
6 **CERTAIN EXPENSES.**

7 (a) \$10,000,000 GROSS RECEIPTS EXCEPTION TO
8 APPLY TO PROPERTY PRODUCED BY THE TAXPAYER.—
9 Section 263A(b) is amended by striking all that follows
10 paragraph (1) and inserting the following new paragraphs:

11 “(2) PROPERTY ACQUIRED FOR RESALE.—Real
12 or personal property described in section 1221(a)(1)
13 which is acquired by the taxpayer for resale.

14 “(3) EXCEPTION FOR TAXPAYER WITH GROSS
15 RECEIPTS OF \$10,000,000 OR LESS.— If the average
16 annual gross receipts of the taxpayer (or any prede-
17 cessor) for the 3-taxable year period ending with the
18 taxable year preceding the taxable year referred to
19 in subparagraph (A) or (B) (as the case may be) do
20 not exceed \$10,000,000—

21 “(A) paragraph (1) shall not apply to any
22 tangible personal property produced by the tax-
23 payer during the taxable year, and

1 “(B) paragraph (2) shall not apply to any
2 personal property acquired during the taxable
3 year by the taxpayer for resale.

4 For purposes of this paragraph, rules similar to the
5 rules of paragraphs (2) and (3) of section 448(b)
6 shall apply.

7 “(4) FILMS, SOUND RECORDINGS, BOOKS,
8 ETC.—For purposes of this subsection, the term
9 ‘tangible personal property’ shall include a film,
10 sound recording, video tape, book, or similar prop-
11 erty.”.

12 (b) EFFECTIVE DATE.—

13 (1) IN GENERAL.—The amendments made by
14 this section shall apply to taxable years beginning
15 after December 31, 2013.

16 (2) CHANGE IN METHOD OF ACCOUNTING.—In
17 the case of any taxpayer required by the amend-
18 ments made by this section to change its method of
19 accounting for its first taxable year beginning after
20 December 31, 2013—

21 (A) such change shall be treated as initi-
22 ated by the taxpayer, and

23 (B) such change shall be treated as made
24 with the consent of the Secretary of the Treas-
25 ury.

1 **SEC. 215. UNIFICATION OF DEDUCTION FOR START-UP AND**
2 **ORGANIZATIONAL EXPENDITURES.**

3 (a) IN GENERAL.—Subsection (a) of section 195 is
4 amended by inserting “and organizational” after “start-
5 up”.

6 (b) ORGANIZATIONAL EXPENDITURES.—Subsection
7 (c) of section 195 is amended by adding at the end the
8 following new paragraph:

9 “(3) ORGANIZATIONAL EXPENDITURES.—The
10 term ‘organizational expenditures’ means any ex-
11 penditure which—

12 “(A) is incident to the creation of a cor-
13 poration or a partnership,

14 “(B) is chargeable to capital account, and

15 “(C) is of a character which, if expended
16 incident to the creation of a corporation or a
17 partnership having a limited life, would be am-
18 ortizable over such life.”.

19 (c) DOLLAR AMOUNTS.—Clause (ii) of section
20 195(b)(1)(A) is amended—

21 (1) by striking “\$5,000” and inserting
22 “\$10,000”, and

23 (2) by striking “\$50,000” and inserting
24 “\$60,000”.

25 (d) CONFORMING AMENDMENTS.—

26 (1) Section 195(b)(1) is amended—

1 (A) by inserting “(or, in the case of a part-
2 nership, the partnership elects)” after “If a tax-
3 payer elects”,

4 (B) by inserting “(or the partnership, as
5 the case may be)” after “the taxpayer” in sub-
6 paragraph (A),

7 (C) by inserting “and organizational” after
8 “start-up” each place it appears.

9 (2) Section 195(b)(2) is amended—

10 (A) by striking “AMORTIZATION PERIOD.—
11 In any case” and inserting the following: “AM-
12 ORTIZATION PERIOD.—

13 “(A) IN GENERAL.—In any case”, and

14 (B) by adding at the end the following new
15 subparagraph:

16 “(B) SPECIAL PARTNERSHIP RULE.—In
17 the case of a partnership, subparagraph (A)
18 shall be applied at the partnership level.”.

19 (3) Section 195(b) is amended by striking para-
20 graph (3).

21 (4)(A) Part VIII of subchapter B of chapter 1
22 is amended by striking section 248 (and by striking
23 the item relating to such section in the table of sec-
24 tions for such part).

1 (B) Section 170(b)(2)(C)(ii) is amended by
2 striking “(except section 248)”.

3 (C) Section 312(n)(3) is amended by striking
4 “Sections 173 and 248” and inserting “section
5 173”.

6 (D) Section 535(b)(3) is amended by striking
7 “(except section 248)”.

8 (E) Section 545(b)(3) is amended by striking
9 “(except section 248)”.

10 (F) Section 834(c)(7) is amended by striking
11 “(except section 248)”.

12 (G) Section 852(b)(2)(C) is amended by strik-
13 ing “(except section 248)”.

14 (H) Section 857(b)(2)(A) is amended by strik-
15 ing “(except section 248)”.

16 (I) Section 1363(b) is amended by inserting
17 “and” at the end of paragraph (2), by striking para-
18 graph (3), and by redesignating paragraph (4) as
19 paragraph (3).

20 (J) Section 1375(b)(1)(B)(i) is amended by
21 striking “(other than the deduction allowed by sec-
22 tion 248, relating to organization expenditures)”.

23 (5) Part I of subchapter K of chapter 1 is
24 amended by striking section 709 (and by striking

1 the item relating to such section in the table of sec-
2 tions for such part).

3 (e) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to expenses paid or incurred after
5 December 31, 2013.

6 **PART 2—TAX RETURN DUE DATE**

7 **SIMPLIFICATION**

8 **SEC. 221. NEW DUE DATE FOR PARTNERSHIP FORM 1065, S**
9 **CORPORATION FORM 1120S, AND C CORPORA-**
10 **TION FORM 1120.**

11 (a) PARTNERSHIPS.—

12 (1) IN GENERAL.—Section 6072 is amended by
13 adding at the end the following new subsection:

14 “(f) RETURNS OF PARTNERSHIPS.—Returns of part-
15 nerships under section 6031 made on the basis of the cal-
16 endar year shall be filed on or before the 15th day of
17 March following the close of the calendar year, and such
18 returns made on the basis of a fiscal year shall be filed
19 on or before the 15th day of the third month following
20 the close of the fiscal year.”.

21 (2) CONFORMING AMENDMENT.—Section
22 6072(a) is amended by striking “6017, or 6031”
23 and inserting “or 6017”.

24 (b) S CORPORATIONS.—

1 (1) IN GENERAL.—So much of subsection (b) of
2 6072 as precedes the second sentence thereof is
3 amended to read as follows:

4 “(b) RETURNS OF CERTAIN CORPORATIONS.—Re-
5 turns of S corporations under sections 6012 and 6037
6 made on the basis of the calendar year shall be filed on
7 or before the 31st day of March following the close of the
8 calendar year, and such returns made on the basis of a
9 fiscal year shall be filed on or before the last day of the
10 third month following the close of the fiscal year.”.

11 (2) CONFORMING AMENDMENTS.—

12 (A) Section 1362(b) is amended—

13 (i) by striking “15th” each place it
14 appears and inserting “last”,

15 (ii) by striking “2½” each place it ap-
16 pears and inserting “3”, and

17 (iii) by striking “2 months and 15
18 days” in paragraph (4) and inserting “3
19 months”.

20 (B) Section 1362(d)(1)(C)(i) is amended
21 by striking “15th” and inserting “last”.

22 (C) Section 1362(d)(1)(C)(ii) is amended
23 by striking “such 15th day” and inserting “the
24 last day of the 3d month thereof”.

1 (c) CONFORMING AMENDMENTS RELATING TO C
2 CORPORATIONS.—

3 (1) Section 170(a)(2)(B) is amended by strik-
4 ing “third month” and inserting “4th month”.

5 (2) Section 563 is amended by striking “third
6 month” each place it appears and inserting “4th
7 month”.

8 (3) Section 1354(d)(1)(B)(i) is amended by
9 striking “3d month” and inserting “4th month”.

10 (4) Subsection (a) and (c) of section 6167 are
11 each amended by striking “third month” and insert-
12 ing “4th month”.

13 (5) Section 6425(a)(1) is amended by striking
14 “third month” and inserting “4th month”.

15 (6) Subsections (b)(2)(A), (g)(3), and (h)(1) of
16 section 6655 are each amended by striking “3rd
17 month” and inserting “4th month”.

18 (d) EFFECTIVE DATE.—The amendments made by
19 this section shall apply to returns for taxable years begin-
20 ning after December 31, 2013.

21 **SEC. 222. MODIFICATION OF DUE DATES BY REGULATION.**

22 In the case of returns for taxable years beginning
23 after December 31, 2013, the Secretary of the Treasury
24 or the Secretary’s delegate shall modify appropriate regu-
25 lations to provide as follows:

1 (1) The maximum extension for the returns of
2 partnerships filing Form 1065 shall be a 6-month
3 period ending on September 15 for calendar year
4 taxpayers.

5 (2) The maximum extension for the returns of
6 trusts filing Form 1041 shall be a 5½-month period
7 ending on September 30 for calendar year taxpayers.

8 (3) The maximum extension for the returns of
9 employee benefit plans filing Form 5500 shall be an
10 automatic 3½-month period ending on November 15
11 for calendar year plans.

12 (4) The maximum extension for the returns of
13 organizations exempt from income tax filing Form
14 990 shall be an automatic 6-month period ending on
15 November 15 for calendar year filers.

16 (5) The due date of Form 3520–A (relating to
17 the Annual Information Return of Foreign Trust
18 with a United States Owner) for calendar year filers
19 shall be April 15 with a maximum extension for a
20 6-month period ending on October 15.

21 (6) The due date of Form TD F 90–22.1 (re-
22 lating to Report of Foreign Bank and Financial Ac-
23 counts) shall be April 15 with a maximum extension
24 for a 6-month period ending on October 15 and with
25 provision for an extension under rules similar to the

1 rules in Treas. Reg. section 1.6081-5. For any tax-
2 payer required to file such Form for the first time,
3 any penalty for failure to timely request for, or file,
4 an extension, may be waived by the Secretary.

5 **SEC. 223. CORPORATIONS PERMITTED STATUTORY AUTO-**
6 **MATIC 6-MONTH EXTENSION OF INCOME TAX**
7 **RETURNS.**

8 (a) IN GENERAL.—Section 6081(b) is amended by
9 striking “3 months” and inserting “6 months”.

10 (b) EFFECTIVE DATE.—The amendment made by
11 this section shall apply to returns for taxable years begin-
12 ning after December 31, 2013.

13 **Subtitle C—[Option 1] Passthrough**
14 **Entities**

15 **PART 1—[OPTION 1] S CORPORATIONS**

16 **SEC. 231. REDUCED RECOGNITION PERIOD FOR BUILT-IN**
17 **GAINS MADE PERMANENT.**

18 (a) IN GENERAL.—Paragraph (7) of section 1374(d)
19 is amended—

20 (1) by striking subparagraphs (A), (B), (C),
21 and (D),

22 (2) by redesignating subparagraph (E) as sub-
23 paragraph (B), and

24 (3) by inserting before subparagraph (B) (as so
25 redesignated) the following new subparagraph:

1 “(3) PASSIVE INVESTMENT INCOME DE-
2 FINED.—

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

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

15 “(C) TREATMENT OF CERTAIN LENDING
16 OR FINANCE COMPANIES.—If the S corporation
17 meets the requirements of section 542(c)(6) for
18 the taxable year, the term ‘passive investment
19 income’ shall not include gross receipts for the
20 taxable year which are derived directly from the
21 active and regular conduct of a lending or fi-
22 nance business (as defined in section
23 542(d)(1)).

24 “(D) TREATMENT OF CERTAIN DIVI-
25 DENDS.—If an S corporation holds stock in a

1 C corporation meeting the requirements of sec-
2 tion 1504(a)(2), the term ‘passive investment
3 income’ shall not include dividends from such C
4 corporation to the extent such dividends are at-
5 tributable to the earnings and profits of such C
6 corporation derived from the active conduct of
7 a trade or business.

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

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

17 “(ii) dividends on assets required to
18 be held by such bank or company, includ-
19 ing stock in the Federal Reserve Bank, the
20 Federal Home Loan Bank, or the Federal
21 Agricultural Mortgage Bank or participa-
22 tion certificates issued by a Federal Inter-
23 mediate Credit Bank.

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

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

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

16 “(G) COORDINATION WITH SECTION
17 1374.—The amount of passive investment in-
18 come shall be determined by not taking into ac-
19 count any recognized built-in gain or loss of the
20 S corporation for any taxable year in the rec-
21 ognition period. Terms used in the preceding
22 sentence shall have the same respective mean-
23 ings as when used in section 1374.”.

1 (2)(A) Subparagraph (J) of section 26(b)(2) is
2 amended by striking “25 percent” and inserting “60
3 percent”.

4 (B) Clause (i) of section 1375(b)(1)(A) is
5 amended by striking “25 percent” and inserting “60
6 percent”.

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

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

14 (3) Subparagraph (B) of section 1362(f)(1) is
15 amended by striking “paragraph (2) or (3) of sub-
16 section (d)” and inserting “subsection (d)(2)”.

17 (d) **EFFECTIVE DATE.**—The amendments made by
18 this section shall apply to taxable years beginning after
19 December 31, 2013.

20 **SEC. 233. EXPANSION OF QUALIFYING BENEFICIARIES OF**
21 **AN ELECTING SMALL BUSINESS TRUST.**

22 (a) **NO LOOK-THROUGH FOR ELIGIBILITY PUR-**
23 **POSES.**—Subparagraph (C) of section 1361(b)(1) is
24 amended by inserting “(determined without regard to sub-
25 section (c)(2)(B)(v))” after “shareholder”.

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall take effect on January 1, 2014.

3 **SEC. 234. CHARITABLE CONTRIBUTION DEDUCTION FOR**
4 **ELECTING SMALL BUSINESS TRUSTS.**

5 (a) IN GENERAL.—Paragraph (2) of section 641(c)
6 is amended by moving subparagraph (D) after subpara-
7 graph (C) and by inserting after subparagraph (D) (as
8 so moved) the following new subparagraph:

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

10 “(ii) For purposes of section 170(b)(1)(G),
11 adjusted gross income shall be computed in the
12 same manner as in the case of an individual,
13 except that the deductions for costs which are
14 paid or incurred in connection with the admin-
15 istration of the trust and which would not have
16 been incurred if the property were not held in
17 such trust shall be treated as allowable in arriv-
18 ing at adjusted gross income.”.

19 (b) EFFECTIVE DATE.—The amendment made by
20 this section shall apply to taxable years beginning after
21 December 31, 2013.

1 **SEC. 235. PERMANENT RULE REGARDING BASIS ADJUST-**
2 **MENT TO STOCK OF S CORPORATIONS MAK-**
3 **ING CHARITABLE CONTRIBUTIONS OF PROP-**
4 **ERTY.**

5 (a) IN GENERAL.—Section 1367(a)(2) (relating to
6 decreases in basis) is amended by striking the last sen-
7 tence.

8 (b) EFFECTIVE DATE.—The amendment made by
9 this section shall apply to contributions made in taxable
10 years beginning after December 31, 2013.

11 **SEC. 236. EXTENSION OF TIME FOR MAKING S CORPORA-**
12 **TION ELECTIONS.**

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

15 “(b) WHEN MADE.—

16 “(1) IN GENERAL.—An election under sub-
17 section (a) may be made by a small business cor-
18 poration for any taxable year not later than the due
19 date for filing the return of tax for such taxable year
20 (including extensions).

21 “(2) CERTAIN ELECTIONS TREATED AS MADE
22 FOR NEXT TAXABLE YEAR.—

23 “(A) CERTAIN LATE ELECTIONS.—If an
24 election is made for any taxable year after the
25 period described in paragraph (1), then such
26 election shall be treated as made for the fol-

1 following taxable year if made during the period
2 described in paragraph (1) with respect to such
3 following taxable year.

4 “(B) CERTAIN TIMELY ELECTIONS.—If—

5 “(i) an election under subsection (a)
6 is made for any taxable year within the pe-
7 riod described in paragraph (1), but

8 “(ii) either—

9 “(I) on 1 or more days in such
10 taxable year and before the day on
11 which the election was made the cor-
12 poration did not meet the require-
13 ments of subsection (b) of section
14 1361, or

15 “(II) 1 or more of the persons
16 who held stock in the corporation dur-
17 ing such taxable year and before the
18 election was made did not consent to
19 the election,

20 then such election shall be treated as made
21 for the following taxable year.

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

24 “(A) an election under subsection (a) is
25 made for any taxable year after the date pre-

1 scribed by this subsection for making such elec-
2 tion for such taxable year or no such election is
3 made for any taxable year, and

4 “(B) the Secretary determines that there
5 was reasonable cause for the failure to timely
6 make such election,

7 the Secretary may treat such an election as timely
8 made for such taxable year.

9 “(4) ELECTION ON TIMELY FILED RETURNS.—
10 Except as otherwise provided by the Secretary, an
11 election under subsection (a) for any taxable year
12 may be made on a timely filed return of tax of the
13 small business corporation for such taxable year.

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

18 (b) REVOCATIONS.—Paragraph (1) of section
19 1362(d) is amended—

20 (1) by striking “subparagraph (D)” in subpara-
21 graph (C) and inserting “subparagraphs (D) and
22 (E)”, and

23 (2) by adding at the end the following new sub-
24 paragraph:

1 “(E) AUTHORITY TO TREAT LATE REVOCA-
2 TIONS AS TIMELY.—If—

3 “(i) a revocation under subparagraph
4 (A) is made for any taxable year after the
5 date prescribed by this paragraph for mak-
6 ing such revocation for such taxable year
7 or no such revocation is made for any tax-
8 able year, and

9 “(ii) the Secretary determines that
10 there was reasonable cause for the failure
11 to timely make such revocation,
12 the Secretary may treat such a revocation as
13 timely made for such taxable year.”.

14 (c) EFFECTIVE DATE.—

15 (1) SUBSECTION (a).—The amendments made
16 by subsection (a) shall apply to elections for taxable
17 years beginning after December 31, 2013.

18 (2) SUBSECTION (b).—The amendments made
19 by subsection (b) shall apply to revocations after De-
20 cember 31, 2013.

21 **SEC. 237. RELOCATION OF C CORPORATION DEFINITION.**

22 (a) IN GENERAL.—Subsection (a) of section 1361 is
23 amended—

24 (1) by striking paragraph (2), and

1 (2) by striking “S CORPORATION DEFINED.—”
2 and all that follows through “For purposes of this
3 title, the term ‘S corporation’ means” and inserting
4 the following: “IN GENERAL.—For purposes of this
5 title, the term ‘S corporation’ means”.

6 (b) CONFORMING AMENDMENT.—Section 7701(a)(3)
7 is amended—

8 (1) by striking “CORPORATION.—The term
9 ‘corporation’ means” and inserting the following:
10 “CORPORATIONS.—

11 “(1) IN GENERAL.—The term ‘corporation’
12 means”, and

13 (2) by adding at the end the following new
14 paragraph:

15 “(2) C CORPORATIONS.—The term ‘C corpora-
16 tion’ means, with respect to any taxable year, a cor-
17 poration which is not an S corporation for such
18 year.”.

19 (c) EFFECTIVE DATE.—The amendments made by
20 this section shall take effect on the date of the enactment
21 of this Act.

1 **PART 2—[OPTION 1] PARTNERSHIPS**
2 **SEC. 241. REPEAL OF RULES RELATING TO GUARANTEED**
3 **PAYMENTS AND LIQUIDATING DISTRIBUTIONS.**
4

5 (a) **PAYMENT TO PARTNER FOR SERVICES OR USE**
6 **OF CAPITAL.**—Section 707 is amended by striking sub-
7 section (c).

8 (b) **PAYMENTS MADE IN LIQUIDATION OF RETIRING**
9 **OR DECEASED PARTNER.**—Subpart B of part II of sub-
10 chapter K of chapter 1 is amended by striking section 736
11 (and by striking the item relating to such section in the
12 table of sections for such subpart).

13 (c) **CONFORMING AMENDMENTS.**—

14 (1) Section 267(e) is amended by striking para-
15 graph (4).

16 (2) Section 357(c)(3)(A) is amended by striking
17 “payment of which either—” and all that follows
18 through “then, for purposes of” and inserting “pay-
19 ment of which would give rise to a deduction, then,
20 for purposes of”.

21 (3) Section 706(a) is amended by striking “and
22 707(c)”.

23 (4) Section 731(d) is amended—

24 (A) by striking “section 736 (relating to
25 payments to a retiring partner or a deceased
26 partner’s successor in interest),”, and

1 (B) by striking “items), and” and insert-
2 ing “items) and”.

3 (5) Section 751(b)(2) is amended—

4 (A) by striking subparagraph (B), and

5 (B) by striking “shall not apply to—” and
6 all that follows through “a distribution of prop-
7 erty” and inserting the following: “shall not
8 apply to a distribution of property”.

9 (6)(A) Subpart D of part II of subchapter K of
10 chapter 1 is amended by striking section 753 (and
11 by striking the item relating to such section in the
12 table of sections for such subpart).

13 (B) Section 691 is amended by striking sub-
14 section (e).

15 (7) Section 1402(a)(13) is amended by striking
16 “other than guaranteed payments described in sec-
17 tion 707(c)” and inserting “other than payments de-
18 scribed in section 707(a)”.

19 (8) Section 1402(a) is amended, in the matter
20 following paragraph (17)—

21 (A) by striking “(after such gross income
22 has been reduced by the sum of all payments to
23 which section 707(c) applies)” in clauses (iii)
24 and (iv), and

1 (B) by striking “(after such gross income
2 has been so reduced)” in clause (iv).

3 (9) Section 2701(c)(1)(B) is amended by insert-
4 ing “or” at the end of clause (i), by striking “, or”
5 at the end of clause (ii) and inserting a period, and
6 by striking clause (iii).

7 (10) Section 7519(d) is amended by striking
8 paragraph (5).

9 (d) EFFECTIVE DATE.—The amendments made by
10 this section shall apply to partnership taxable years begin-
11 ning after December 31, 2013.

12 **SEC. 242. MANDATORY ADJUSTMENTS TO BASIS OF PART-**
13 **nership PROPERTY IN CASE OF TRANSFER**
14 **OF PARTNERSHIP INTERESTS.**

15 (a) IN GENERAL.—Section 743 is amended—

16 (1) by striking subsections (a), (c), (d), (e), and
17 (f) and by redesignating subsection (b) as subsection
18 (a),

19 (2) in subsection (a) (as so redesignated) by
20 striking “with respect to which the election provided
21 in section 754 is in effect or which has a substantial
22 built-in loss immediately after such transfer”, and

23 (3) by adding at the end the following new sub-
24 section:

25 “(b) ALLOCATION OF BASIS.—

1 “(1) GENERAL RULE.—Any increase or de-
2 crease in the adjusted basis of partnership property
3 under subsection (a) shall, except as provided in
4 paragraph (2), be allocated—

5 “(A) in a manner which has the effect of
6 reducing the difference between the fair market
7 value and the adjusted basis of partnership
8 properties, or

9 “(B) in any other manner permitted by
10 regulations prescribed by the Secretary.

11 “(2) SPECIAL RULE.—In applying the allocation
12 rules provided in paragraph (1), increases or de-
13 creases in the adjusted basis of partnership property
14 arising from a distribution of, or a transfer of an in-
15 terest attributable to, property consisting of—

16 “(A) capital assets and property described
17 in section 1231(b), or

18 “(B) any other property of the partner-
19 ship,

20 shall be allocated to partnership property of a like
21 character except that the basis of any such partner-
22 ship property shall not be reduced below zero.”.

23 (b) CONFORMING AMENDMENTS.—

1 (1) Section 732 is amended by striking sub-
2 section (d) and by redesignating subsections (e) and
3 (f) as subsections (d) and (e), respectively.

4 (2) Section 761(e)(2) is amended by striking
5 “optional”.

6 (3) Section 774(a) is amended by striking “sec-
7 tion 743(b)” both places it appears and inserting
8 “section 743(a)”.

9 (4) The heading for section 743 is amended to
10 read as follows: “**ADJUSTMENT TO BASIS OF**
11 **PARTNERSHIP PROPERTY.**”

12 (5) The heading for subsection (a) (as redesign-
13 ated by this Act) of section 743 is amended by
14 striking “ADJUSTMENT TO BASIS OF PARTNERSHIP
15 PROPERTY” and inserting “IN GENERAL”.

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to transfers after December 31,
18 2013.

19 **SEC. 243. MANDATORY ADJUSTMENTS TO BASIS OF UNDIS-**
20 **TRIBUTED PARTNERSHIP PROPERTY.**

21 (a) IN GENERAL.—Section 734 is amended to read
22 as follows:

1 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
2 **PARTNERSHIP PROPERTY.**

3 “(a) IN GENERAL.—In the case of any distribution
4 to a partner, the partnership shall adjust the basis of part-
5 nership property such that each remaining partner’s net
6 liquidation amount immediately after such distribution is
7 equal to such partner’s net liquidation amount imme-
8 diately before such distribution.

9 “(b) DISTRIBUTIONS OTHER THAN IN LIQUIDATION
10 OF A PARTNER’S INTEREST.—In the case of any distribu-
11 tion to a partner other than in liquidation of such part-
12 ner’s interest, proper adjustment shall be made under sub-
13 section (a) with respect to such partner to take into ac-
14 count—

15 “(1) the amount of any gain recognized by such
16 partner with respect to such distribution under sec-
17 tion 731(a), and

18 “(2) the amount of any gain or loss which
19 would be recognized by such partner if such partner
20 sold the property distributed at fair market value
21 immediately after such distribution.

22 “(c) NET LIQUIDATION AMOUNT.—For purposes of
23 this section, the term ‘net liquidation amount’ means, with
24 respect to any partner, the net amount of gain or loss (if
25 any) which would be taken into account by the partner
26 under section 702 if the partnership sold all of its assets

1 at fair market value (and no other amounts were taken
2 into account under such section).

3 “(d) ALLOCATION OF BASIS.—

4 “(1) DECREASES IN BASIS.—Any decrease in
5 the adjusted basis of partnership property which is
6 required under this section—

7 “(A) shall be made in accordance with
8 paragraph (3) of section 732(c), and

9 “(B) shall be made first with respect to
10 property other than unrealized receivables (as
11 defined in section 751(c)) and inventory (as de-
12 fined in section 751(d)) to the extent thereof.

13 If any such decrease is prevented by the absence of
14 sufficient adjusted basis of partnership property,
15 each partner shall recognize gain in the amount of
16 such partner’s distributive share of such prevented
17 decrease. Such gain shall be treated as gain from
18 the sale of the partner’s partnership interest.

19 “(2) INCREASES IN BASIS.—Any increase in the
20 adjusted basis of partnership property which is re-
21 quired under this section—

22 “(A) shall be made in accordance with
23 paragraph (2) of section 732(c), and

24 “(B) shall be made only with respect to
25 property other than unrealized receivables (as

1 defined in section 751(c)) and inventory (as de-
2 fined in section 751(d)).

3 If any such increase is prevented by the absence of
4 property described in subparagraph (B), each part-
5 ners shall recognize a loss in the amount of such
6 partner's distributive share of such prevented in-
7 crease. Such loss shall be treated as a loss from the
8 sale of the partner's partnership interest.

9 “(e) NO ALLOCATION OF BASIS DECREASE TO
10 STOCK OF CORPORATE PARTNER.—In making an alloca-
11 tion under subsection (d) of any decrease in the adjusted
12 basis of partnership property required under subsection
13 (a)—

14 “(1) no allocation may be made to stock in a
15 corporation (or any person related (within the mean-
16 ing of section 267(b) or 707(b)(1)) to such corpora-
17 tion) which is a partner in the partnership, and

18 “(2) any amount not allocable to stock by rea-
19 son of paragraph (1) shall be allocated under sub-
20 section (d) to other partnership property.

21 Gain shall be recognized by the partnership to the extent
22 that the amount required to be allocated to other partner-
23 ship property under paragraph (2) exceeds the aggregate
24 adjusted basis of such other property.”.

25 (b) CONFORMING AMENDMENTS.—

1 (1)(A) Subpart D of part II of subchapter K of
2 chapter 1 is amended by striking sections 754 and
3 755 (and by striking items relating to such sections
4 in the table of sections of such subpart).

5 (B) Clause (ii) of section 706(d)(2)(D) is
6 amended by striking “section 755” and inserting
7 “section 743(b)”.

8 (2) Subsection (d) of section 1060 is amend-
9 ed—

10 (A) by striking “section 755” in paragraph

11 (1) and inserting “sections 734 and 743”, and

12 (B) by striking “section 755” in paragraph

13 (2) and inserting “section 734 or 743”.

14 (c) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to distributions after December 31,
16 2013.

17 **SEC. 244. CORRESPONDING ADJUSTMENTS TO BASIS OF**
18 **PROPERTIES HELD BY PARTNERSHIP WHERE**
19 **PARTNERSHIP BASIS ADJUSTED.**

20 (a) IN GENERAL.—Subpart B of part II of sub-
21 chapter K of chapter 1, as amended by this Act, is amend-
22 ed by inserting after section 735 the following new section:

1 **“SEC. 736. CORRESPONDING ADJUSTMENT TO BASIS OF**
2 **PROPERTIES HELD BY LOWER-TIER PART-**
3 **nership IN CASE OF UPPER-TIER PARTNER-**
4 **SHIP BASIS ADJUSTMENTS.**

5 “(a) DISTRIBUTIONS BY UPPER-TIER PARTNER-
6 SHIP.—In the case of any distribution of property to a
7 partner by an upper-tier partnership, if such distribution
8 results in an adjustment in the upper-tier partnership’s
9 adjusted basis in an interest in a lower-tier partnership
10 under section 734, then such lower-tier partnership shall
11 make a corresponding adjustment to the adjusted basis
12 of its partnership property.

13 “(b) DISTRIBUTIONS OF INTERESTS IN LOWER-TIER
14 PARTNERSHIP.—In the case of any distribution of an in-
15 terest in a lower-tier partnership by an upper-tier partner-
16 ship—

17 “(1) if the adjusted basis of such interest in the
18 hands of the upper-tier partnership (determined im-
19 mediately before such distribution) exceeds the ad-
20 justed basis of such interest in the hands of the dis-
21 tributee partner (determined immediately after such
22 distribution), then such lower-tier partnership shall
23 decrease the adjusted basis of its partnership prop-
24 erty by the amount of such excess, or

25 “(2) if the adjusted basis of such interest in the
26 hands of the distributee partner (determined imme-

1 diately after such distribution) exceeds the adjusted
2 basis of such interest in the hands of the upper-tier
3 partnership (determined immediately before such
4 distribution), then such lower-tier partnership shall
5 increase the adjusted basis of its partnership prop-
6 erty by the amount of such excess.

7 “(c) DISPOSITIONS OF INTERESTS IN UPPER-TIER
8 PARTNERSHIP.—In the case of a disposition of an interest
9 in an upper-tier partnership which holds an interest in a
10 lower-tier partnership, if there is an adjustment to the ad-
11 justed basis of the lower-tier partnership under section
12 743, then such lower-tier partnership shall make a cor-
13 responding adjustment to the adjusted basis of its part-
14 nership property.

15 “(d) MULTI-TIERED PARTNERSHIPS.—In the case of
16 any adjustment under subsection (a), (b), or (c) in the
17 adjusted basis of an interest in another partnership, such
18 other partnership shall make a corresponding adjustment
19 in the adjusted basis of its partnership property.

20 “(e) ALLOCATION OF BASIS; RECOGNITION OF
21 GAIN.—In the case of any adjustment in the adjusted
22 basis of partnership property—

23 “(1) under subsection (a), (b), (c), or (d), such
24 adjustment shall be made only with respect to the
25 upper-tier partnership’s proportionate share (as de-

1 terminated under section 743(a)) of the adjusted basis
2 of the lower-tier partnership's property,

3 “(2) under subsection (a) or (b) (or so much of
4 subsection (d) as relates to either such subsection),
5 rules similar to the rules of section 734(d) shall
6 apply, and

7 “(3) under subsection (c) (or so much of sub-
8 section (d) as relates to such subsection), rules simi-
9 lar to the rules of section 743(b) shall apply.

10 “(f) REPORTING.—In the case of any adjustment in
11 the adjusted basis of partnership property by a lower-tier
12 partnership under this section by reason of a distribution
13 by, or a disposition of an interest in, an upper-tier part-
14 nership, such upper-tier partnership shall furnish (in such
15 manner as the Secretary shall prescribe) to such lower-
16 tier partnership such information as is necessary to enable
17 such lower-tier partnership to make such adjustment.

18 “(g) UPPER- AND LOWER-TIER PARTNERSHIPS.—
19 For purposes of this section—

20 “(1) UPPER-TIER PARTNERSHIP.—The term
21 ‘upper-tier partnership’ means a partnership owning
22 an interest in another partnership.

23 “(2) LOWER-TIER PARTNERSHIP.—The term
24 ‘lower-tier partnership’ means the partnership re-

1 ferred to in paragraph (1) an interest in which is
2 owned by the upper-tier partnership.”.

3 (b) EFFECTIVE DATES.—The amendments made by
4 this section shall apply to distributions and transfers after
5 December 31, 2013.

6 **SEC. 245. CHARITABLE CONTRIBUTIONS AND FOREIGN**
7 **TAXES TAKEN INTO ACCOUNT IN DETER-**
8 **MINING LIMITATION ON ALLOWANCE OF**
9 **PARTNER’S SHARE OF LOSS.**

10 (a) IN GENERAL.—Subsection (d) of section 704 is
11 amended—

12 (1) by striking “A partner’s distributive share”
13 and inserting the following:

14 “(1) IN GENERAL.—A partner’s distributive
15 share”,

16 (2) by striking “Any excess of such loss” and
17 inserting the following:

18 “(2) CARRYOVER.—Any excess of such loss”,
19 and

20 (3) by adding at the end the following new
21 paragraph:

22 “(3) SPECIAL RULES.—In determining the
23 amount of any loss under paragraph (1), there shall
24 be taken into account as a deduction the partner’s
25 distributive share of—

1 “(A) the adjusted basis of charitable con-
2 tributions described in paragraph (4) of section
3 702(a), and

4 “(B) the amount of taxes described in
5 paragraph (6) of such section.”.

6 (b) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to partnership taxable years begin-
8 ning after December 31, 2013.

9 **SEC. 246. REVISIONS RELATED TO UNREALIZED RECEIV-**
10 **ABLES AND INVENTORY ITEMS.**

11 (a) REPEAL OF REQUIREMENT THAT INVENTORY BE
12 SUBSTANTIALLY APPRECIATED IN CERTAIN PARTNER-
13 SHIP DISTRIBUTIONS TREATED AS SALE OR EX-
14 CHANGE.—

15 (1) IN GENERAL.—Clause (ii) of section
16 751(b)(1)(A) is amended by striking “which have
17 appreciated substantially in value”.

18 (2) CONFORMING AMENDMENT.—Section
19 751(b) is amended by striking paragraph (3).

20 (3) EFFECTIVE DATE.—The amendments made
21 by this subsection shall apply to distributions after
22 December 31, 2013.

23 (b) REVISION OF REGULATIONS RELATING TO
24 TREATMENT OF UNREALIZED RECEIVABLES AND INVEN-
25 TORY ITEMS.—The Secretary of the Treasury shall revise

1 regulations issued under section 751(b) of the Internal
2 Revenue Code of 1986 to take into account the partner's
3 share of income and gain rather than the partner's share
4 of partnership assets.

5 (c) SIMPLIFICATION OF DEFINITION OF UNREALIZED
6 RECEIVABLES.—

7 (1) IN GENERAL.—Section 751(c) is amended
8 by striking all that follows paragraph (2) and insert-
9 ing the following:

10 “For purposes of this section and sections 731, 732, 734,
11 736, and 741, such term also includes any property other
12 than inventory items, but only to the extent of the amount
13 which would be treated as ordinary income if (at the time
14 of the transaction described in the applicable section) such
15 property had been sold by the partnership for its fair mar-
16 ket value.”.

17 (2) EFFECTIVE DATE.—The amendment made
18 by this subsection shall apply to partnership taxable
19 years beginning after December 31, 2013.

20 **SEC. 247. REPEAL OF TIME LIMITATION ON TAXING**
21 **PRECONTRIBUTION GAIN.**

22 (a) IN GENERAL.—Subparagraph (B) of section
23 704(c)(1) is amended by striking “within 7 years of being
24 contributed”.

1 (b) CONFORMING AMENDMENT.—Paragraph (1) of
2 section 737(b) is amended by striking “within 7 years of
3 the distribution”.

4 (c) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to property contributed to a part-
6 nership after December 31, 2013.

7 **Subtitle C—[Option 2] Unified** 8 **Rules for Passthroughs**

9 **SEC. 231. UNIFIED RULES FOR PASSTHROUGHS.**

10 (a) REPEAL OF PARTNERSHIP RULES.—Chapter 1 is
11 amended by striking subchapter K (and by striking the
12 item relating to such subchapter in the table of sub-
13 chapters for such chapter).

14 (b) REPEAL OF S CORPORATION RULES.—Chapter 1
15 is amended by striking subchapter S (and by striking the
16 item relating to such subchapter in the table of subchapter
17 for such chapter).

18 (c) APPLICATION OF UNIFIED RULES FOR
19 PASSTHROUGHS.—Chapter 1 is amended by inserting
20 after subchapter J the following new subchapter:

21 **“Subchapter K—Passthroughs**

“PART I—GENERAL PROVISIONS

“PART II—TAX TREATMENT OF OWNERS

“PART III—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

“PART IV—DEFINITIONS AND OTHER SPECIAL RULES

“PART V—RULES RELATING TO PASSTHROUGH CORPORATIONS

1 **“PART I—GENERAL PROVISIONS**

“Sec. 701. Tax treatment of passthrough.

“Sec. 702. Passthrough defined.

“Sec. 703. Passthrough corporation.

“Sec. 704. Computation of passthrough items.

2 **“SEC. 701. TAX TREATMENT OF PASSTROUGH.**

3 “(a) IN GENERAL.—Except as otherwise provided in
4 this subchapter, a passthrough shall not be subject to the
5 taxes imposed by this chapter.

6 “(b) WITHHOLDING.—For withholding on owner’s
7 distributive share of passthrough income, see subchapter
8 B of chapter 24.

9 **“SEC. 702. PASSTROUGH DEFINED.**

10 “(a) IN GENERAL.—For purposes of this subchapter,
11 the term ‘passthrough’ means—

12 “(1) any partnership (within the meaning of
13 section 761(a) as in effect before its repeal by the
14 Tax Reform Act of 2013), and

15 “(2) any passthrough corporation.

16 “(b) EXCEPTION FOR CERTAIN UNINCORPORATED
17 ORGANIZATIONS.—Under regulations the Secretary may,
18 at the election of all the members of an unincorporated
19 organization, exclude such organization from the applica-
20 tion of all or part of this subchapter, if—

21 “(1) it is availed of—

22 “(A) for investment purposes only and not
23 for the active conduct of a business,

1 “(B) for the joint production, extraction,
2 or use of property, but not for the purpose of
3 selling services or property produced or ex-
4 tracted, or

5 “(C) by dealers in securities for a short pe-
6 riod for the purpose of underwriting, selling, or
7 distributing a particular issue of securities, and

8 “(2) the income of the members of the organi-
9 zation may be adequately determined without the
10 computation of passthrough items.

11 “(c) CERTAIN JOINT VENTURES OF SPOUSES.—

12 “(1) IN GENERAL.—In the case of a qualified
13 joint venture conducted by a husband and wife who
14 file a joint return for the taxable year, for purposes
15 of this title—

16 “(A) such joint venture shall not be treat-
17 ed as a passthrough,

18 “(B) all items of income, gain, loss, deduc-
19 tion, and credit shall be divided between the
20 spouses in accordance with their respective in-
21 terests in the venture, and

22 “(C) each spouse shall take into account
23 such spouse’s respective share of such items as
24 if they were attributable to a trade or business
25 conducted by such spouse as a sole proprietor.

1 “(2) QUALIFIED JOINT VENTURE.—For pur-
2 poses of this subsection, the term ‘qualified joint
3 venture’ means any joint venture involving the con-
4 duct of a trade or business if—

5 “(A) the only members of such joint ven-
6 ture are a husband and wife,

7 “(B) both spouses materially participate
8 (within the meaning of section 469(h) without
9 regard to paragraph (5) thereof) in such trade
10 or business, and

11 “(C) both spouses elect the application of
12 this subsection.

13 **“SEC. 703. PASSTHROUGH CORPORATION.**

14 “(a) IN GENERAL.—For purposes of this subchapter,
15 the term ‘passthrough corporation’ means, with respect to
16 any taxable year, any corporation for which an election
17 is in effect under this subsection for such taxable year.
18 An election under this subsection shall apply for the tax-
19 able year for which made and all subsequent taxable years
20 unless revoked with the consent of the Secretary.

21 “(b) EXCEPTIONS.—

22 “(1) IN GENERAL.—Such term shall not include
23 any corporation which is—

24 “(A) publicly traded,

1 “(B) a financial institution which uses the
2 reserve method of accounting for bad debts de-
3 scribed in section 585,

4 “(C) an insurance company subject to tax
5 under subchapter L, or

6 “(D) a DISC or former DISC.

7 “(2) PUBLICLY TRADED.—For purposes of this
8 subsection, a corporation shall be treated as publicly
9 traded if—

10 “(A) shares of such corporation are traded
11 on any established securities market (within the
12 meaning of section 1273(b) or 7704(b)), or

13 “(B) shares of such corporation are readily
14 tradable on a secondary market (or the sub-
15 stantial equivalent thereof).

16 “(c) ELECTION.—

17 “(1) IN GENERAL.—Except as otherwise pro-
18 vided in this subsection, an election under subsection
19 (a) for any taxable year shall be made not later than
20 the due date for filing the return of tax for such tax-
21 able year (including extensions).

22 “(2) CERTAIN LATE ELECTIONS TREATED AS
23 MADE FOR NEXT TAXABLE YEAR.—If an election is
24 made for any taxable year after the period described
25 in paragraph (1), then such election shall be treated

1 as made for the following taxable year if made dur-
2 ing the period described in paragraph (1) with re-
3 spect to such following taxable year.

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

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

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

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

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

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

1 “(d) TRANSITION RULE FOR PRE-EXISTING S COR-
2 PORATIONS.—

3 “(1) IN GENERAL.—In the case of a corpora-
4 tion which was an S corporation (as defined in sec-
5 tion 1361(a)(1) as in effect before its repeal) for
6 such corporation’s last taxable year beginning before
7 January 1, 2014, such corporation shall be treated
8 as having made the election under subsection (a) for
9 such corporation’s first taxable year beginning after
10 December 31, 2013, unless such corporation elects
11 (under rules similar to the rules of subsection (e))
12 to have this subsection not apply.

13 “(2) CROSS REFERENCE.—For application of
14 part V to pre-existing S corporations, see section
15 776.

16 **“SEC. 704. COMPUTATION OF PASSTHROUGH ITEMS.**

17 “(a) IN GENERAL.—The taxable income of the pass-
18 through (and each of the passthrough items described in
19 section 711) shall be computed in the same manner as
20 in the case of an individual, except that—

21 “(1) the following deductions shall not be al-
22 lowed to the passthrough:

23 “(A) the deductions for personal exemp-
24 tions provided in section 151,

1 “(B) the deduction for taxes provided in
2 section 164(a) with respect to taxes, described
3 in section 901, paid or accrued to foreign coun-
4 tries and to possessions of the United States,

5 “(C) the deduction for charitable contribu-
6 tions provided in section 170,

7 “(D) the net operating loss deduction pro-
8 vided in section 172,

9 “(E) the additional itemized deductions for
10 individuals provided in part VII of subchapter
11 B, and

12 “(F) the deduction for depletion under sec-
13 tion 611 with respect to oil and gas wells, and

14 “(2) section 291 shall apply if the passthrough
15 (or any predecessor) was a C corporation for any of
16 the 3 immediately preceding taxable years.

17 “(b) ELECTIONS MADE BY PASSTHROUGH.—

18 “(1) IN GENERAL.—Except as provided in para-
19 graph (2), any election affecting the computation of
20 passthrough items shall be made by the pass-
21 through.

22 “(2) EXCEPTION.—In the case of a pass-
23 through, elections under section 901 (relating to
24 taxes of foreign countries and possessions of the

1 United States) shall be made by each owner sepa-
2 rately.

3 **“PART II—TAX TREATMENT OF OWNERS**

“Sec. 711. Passthrough of items to owners.

“Sec. 712. Determination of owner’s distributive share.

“Sec. 713. Determination of owner’s basis in passthrough interest.

4 **“SEC. 711. PASSTHROUGH OF ITEMS TO OWNERS.**

5 “(a) DETERMINATION OF OWNER’S TAX LIABIL-
6 ITY.—In determining the tax under this chapter of an
7 owner of a passthrough, there shall be taken into account
8 such owner’s distributive share of—

9 “(1) except as provided in section 704, each
10 item of income, gain, loss, deduction, or credit of the
11 passthrough,

12 “(2) charitable contributions (as defined in sec-
13 tion 170(c)) of the passthrough, and

14 “(3) taxes, described in section 901, paid or ac-
15 crued (or deemed to have paid or accrued) by the
16 passthrough to foreign countries and to possessions
17 of the United States.

18 “(b) CHARACTER PASSED THROUGH.—The character
19 of any passthrough item shall be determined as if such
20 item were realized directly from the source from which re-
21 alized by the passthrough, or incurred in the same manner
22 as incurred by the passthrough.

23 “(c) PROVISION OF INFORMATION.—To the extent
24 provided by the Secretary in regulations or other guidance,

1 the passthrough shall provide such information with re-
2 spect to the characteristics of any passthrough item as is
3 necessary for the owner to determine his taxable income.

4 **“SEC. 712. DETERMINATION OF OWNER’S DISTRIBUTIVE**
5 **SHARE.**

6 “(a) IN GENERAL.—An owner’s distributive share
7 shall, except as otherwise provided in this subchapter, be
8 determined by the ownership agreement.

9 “(b) DISTRIBUTIVE SHARE MUST BE CONSISTENT
10 WITH OWNER’S ECONOMIC INTEREST.—

11 “(1) IN GENERAL.—If any owner’s distributive
12 share under the ownership agreement is inconsistent
13 with such owner’s economic interest in the pass-
14 through, the distributive share of such owner shall
15 be adjusted (consistent with the requirements of
16 subsection (c)) so as to be consistent with such own-
17 er’s economic interest in the passthrough.

18 “(2) DISTRIBUTIVE SHARE NOT DETERMINED
19 UNDER OWNERSHIP AGREEMENT.—If the ownership
20 agreement does not provide as to an owner’s dis-
21 tributive share, the distributive share of such owner
22 shall be determined (consistent with the require-
23 ments of subsection (c)) in accordance with such
24 owner’s economic interest in the passthrough.

1 “(3) CORRESPONDING ADJUSTMENTS TO DIS-
2 TRIBUTIVE SHARE OF OTHER OWNERS.—If any own-
3 er’s distributive share is adjusted or determined
4 under this subsection, the distributive shares of all
5 other owners shall be properly adjusted consistent
6 with the requirements of subsection (c) and with
7 each owner’s economic interest in the passthrough.

8 “(4) DETERMINATION OF ECONOMIC INTER-
9 EST.—For purposes of this subsection and section
10 743(a), an owner’s economic interest in a pass-
11 through shall be determined by taking into account
12 all facts and circumstances.

13 “(c) RESTRICTION ON DIFFERENT DISTRIBUTIVE
14 SHARES OF ITEMS TO SAME OWNER.—

15 “(1) DISTRIBUTIVE SHARE OF ITEMS IN SAME
16 CATEGORY MUST BE THE SAME.—Except as pro-
17 vided in subsection (d) and section 751(b), if an
18 owner receives a distributive share of any pass-
19 through item, such owner shall receive the same dis-
20 tributive share (when expressed as a percentage) of
21 all other passthrough items which are in the same
22 category.

23 “(2) CATEGORIES OF PASSTHROUGH ITEMS.—
24 For purposes of this section—

1 “(A) IN GENERAL.—Each of the following
2 clauses is a separate category of passthrough
3 items:

4 “(i) Ordinary items.

5 “(ii) Capital gain rate items.

6 “(iii) Credits.

7 “(B) CAPITAL GAIN RATE ITEMS.—The
8 term ‘capital gain rate items’ means—

9 “(i) any item of gain or loss from the
10 sale or exchange of a capital asset, and

11 “(ii) any qualified dividend income (as
12 defined in section 1(h)(11)).

13 “(C) ORDINARY ITEMS.—The term ‘ordi-
14 nary items’ means any passthrough item which
15 is not a capital gain rate item, a credit, or a tax
16 to which paragraph (3) applies.

17 “(3) FOREIGN TAXES.—Notwithstanding any
18 other provision of this section, an owner’s distribu-
19 tive share of any tax described in section 711(a)(3)
20 shall be the same as such owner’s distributive share
21 of the passthrough items on which such tax was im-
22 posed.

23 “(4) REGULATIONS TO PREVENT AVOIDANCE.—
24 The Secretary shall issue regulations or other guid-
25 ance which prevent the avoidance of the purposes of

1 this subsection. Such regulations or other guidance
2 shall include rules which provide for the application
3 of this subsection with respect to passthroughs
4 which are treated as a single employer under sub-
5 section (a) or (b) of section 52 or subsection (m) or
6 (o) of section 414.

7 “(d) CONTRIBUTED PROPERTY.—

8 “(1) IN GENERAL.—Under regulations pre-
9 scribed by the Secretary—

10 “(A) income, gain, loss, and deduction with
11 respect to property contributed to the pass-
12 through by an owner shall be shared among the
13 owners so as to take account of the variation
14 between the basis of the property to the pass-
15 through and its fair market value at the time
16 of contribution,

17 “(B) if any property so contributed is dis-
18 tributed (directly or indirectly) by the pass-
19 through (other than to the contributing
20 owner)—

21 “(i) the contributing owner shall be
22 treated as recognizing loss from the sale of
23 such property in an amount equal to the
24 loss that would have been allocated to such
25 owner under subparagraph (A) by reason

1 of the variation described in subparagraph
2 (A) if the property had been sold at its fair
3 market value at the time of distribution,

4 “(ii) the character of such loss shall
5 be determined by reference to the char-
6 acter of the loss that would have resulted
7 if such property had been sold by the pass-
8 through to the distributee, and

9 “(iii) appropriate adjustments shall be
10 made to the adjusted basis of the contrib-
11 uting owner’s passthrough interest and to
12 the adjusted basis of the property distrib-
13 uted to reflect any loss recognized under
14 this subparagraph, and

15 “(C) if any property so contributed has a
16 built-in loss—

17 “(i) such built-in loss shall be taken
18 into account only in determining the
19 amount of items allocated to the contrib-
20 uting owner, and

21 “(ii) except as provided in regulations,
22 in determining the amount of items allo-
23 cated to other owners, the basis of the con-
24 tributed property in the hands of the pass-
25 through shall be treated as being equal to

1 its fair market value at the time of con-
2 tribution.

3 For purposes of subparagraph (B), the term
4 ‘built-in loss’ means the excess of the adjusted
5 basis of the property (determined without re-
6 gard to subparagraph (C)(ii)) over its fair mar-
7 ket value at the time of contribution.

8 “(2) OTHER RULES.—Under regulations pre-
9 scribed by the Secretary, rules similar to the rules
10 of paragraph (1) shall apply to contributions by an
11 owner (using the cash receipts and disbursements
12 method of accounting) of accounts payable and other
13 accrued but unpaid items. Any reference in para-
14 graph (1) to the contributing owner shall be treated
15 as including a reference to any successor of such
16 owner.

17 “(e) LIMITATION ON ALLOWANCE OF LOSSES.—

18 “(1) IN GENERAL.—An owner’s distributive
19 share of passthrough loss (including capital loss)
20 shall be allowed only to the extent of the adjusted
21 basis of such owner’s passthrough interest at the
22 end of the passthrough year in which such loss oc-
23 curred.

24 “(2) CARRYOVER.—Any excess of such loss over
25 such basis shall be allowed as a deduction at the end

1 of the passthrough year in which such excess is re-
2 paid to the passthrough.

3 “(3) SPECIAL RULES.—In determining the
4 amount of any loss under paragraph (1), there shall
5 be taken into account as a deduction the owner’s
6 distributive share of—

7 “(A) the adjusted basis of charitable con-
8 tributions described in paragraph (2) of section
9 711(a), and

10 “(B) the amount of taxes described in
11 paragraph (3) of such section.

12 “(f) FAMILY PASSTHROUGHS.—

13 “(1) RECOGNITION OF PASSTHROUGH INTER-
14 EST CREATED BY PURCHASE OR GIFT.—An indi-
15 vidual shall be recognized as an owner for purposes
16 of this subtitle if—

17 “(A) he owns a capital interest in a pass-
18 through in which capital is a material income-
19 producing factor, and

20 “(B) such capital interest was derived by
21 purchase or gift from a member of such individ-
22 ual’s family.

23 “(2) DISTRIBUTIVE SHARE OF DONEE INCLUD-
24 IBLE IN GROSS INCOME.—In the case of any pass-
25 through interest created by gift, the distributive

1 share of the donee under the ownership agreement
2 shall be properly adjusted under subsection (b)(1) to
3 the extent that such share is determined without al-
4 lowance of reasonable compensation for services ren-
5 dered to the passthrough by the donor and to the ex-
6 tent that the portion of such share attributable to
7 donated capital is proportionately greater than the
8 share of the donor attributable to the donor's cap-
9 ital. The distributive share of an owner in the earn-
10 ings of the passthrough shall not be diminished be-
11 cause of absence due to military service.

12 “(3) PURCHASE OF PASSTHROUGH INTEREST
13 BY MEMBER OF FAMILY.—For purposes of this sec-
14 tion, a passthrough interest purchased by one mem-
15 ber of a family from another shall be considered to
16 be created by gift from the seller, and the fair mar-
17 ket value of the purchased interest shall be consid-
18 ered to be donated capital.

19 “(4) FAMILY.—For purposes of this subsection,
20 the “family” of any individual shall include only his
21 spouse, ancestors, and lineal descendants, and any
22 trusts for the primary benefit of such persons.

1 **“SEC. 713. DETERMINATION OF OWNER’S BASIS IN PASS-**
2 **THROUGH INTEREST.**

3 “The adjusted basis of an owner’s passthrough inter-
4 est shall be the basis of such interest determined under
5 section 722 (relating to basis with respect to contributed
6 property) or section 742 (relating to basis of transferee
7 owner’s passthrough interest)—

8 “(1) increased by the sum of his distributive
9 share for the taxable year and prior taxable years
10 of—

11 “(A) the passthrough’s items of income
12 and gain,

13 “(B) income of the passthrough exempt
14 from tax under this title, and

15 “(C) the excess of the deductions for deple-
16 tion over the basis of the property subject to
17 depletion, and

18 “(2) decreased (but not below zero) by—

19 “(A) the reductions provided under section
20 733,

21 “(B) the sum of his distributive share for
22 the taxable year and prior taxable years of—

23 “(i) the passthrough’s items of loss
24 and deduction, and

25 “(ii) expenditures of the passthrough
26 not deductible in computing its taxable in-

1 come and not properly chargeable to cap-
2 ital account, and

3 “(C) the amount of the owner’s distribu-
4 tive share of the deduction for depletion for any
5 oil and gas property of the passthrough to the
6 extent such deduction does not exceed the pro-
7 portionate share of the adjusted basis of such
8 property allocated to such owner under section
9 613A(c)(7)(D).

10 **“PART III—CONTRIBUTIONS, DISTRIBUTIONS,**
11 **AND TRANSFERS**

 “SUBPART A—CONTRIBUTIONS

 “SUBPART B—DISTRIBUTIONS

 “SUBPART C—TRANSFERS

 “SUBPART D—OTHER PROVISIONS RELATING TO CONTRIBUTIONS,
 DISTRIBUTIONS, AND TRANSFERS

12 **“Subpart A—Contributions**

 “Sec. 721. Nonrecognition of gain or loss on contribution.

 “Sec. 722. Basis with respect to contributed property.

 “Sec. 723. Character of gain or loss on contributed unrealized receivables, in-
 ventory items, and capital loss property.

13 **“SEC. 721. NONRECOGNITION OF GAIN OR LOSS ON CON-**
14 **TRIBUTION.**

15 “(a) IN GENERAL.—No gain or loss shall be recog-
16 nized to a passthrough or to any of its owners in the case
17 of a contribution of property to the passthrough in ex-
18 change for a passthrough interest.

1 “(b) SPECIAL RULE.—Subsection (a) shall not apply
2 to gain realized on a transfer of property to any pass-
3 through which is treated as an investment company (with-
4 in the meaning of section 351) or which would be so treat-
5 ed if such passthrough were incorporated.

6 “(c) REGULATIONS RELATING TO CERTAIN TRANS-
7 FERS TO PASSTHROUGHS.—The Secretary may provide by
8 regulations that subsection (a) shall not apply to gain real-
9 ized on the transfer of property to a passthrough if such
10 gain, when recognized, will be includible in the gross in-
11 come of a person other than a United States person.

12 “(d) TRANSFERS OF INTANGIBLES.—For treatment
13 of intangibles transferred to a passthrough as sold, see
14 section 367(d).

15 **“SEC. 722. BASIS WITH RESPECT TO CONTRIBUTED PROP-**
16 **ERTY.**

17 “(a) BASIS OF CONTRIBUTING OWNER’S PASS-
18 THROUGH INTEREST.—The basis of a passthrough inter-
19 est acquired by a contribution of property, including
20 money, to the passthrough shall be the amount of such
21 money and the adjusted basis of such property to the con-
22 tributing owner at the time of the contribution increased
23 by the amount (if any) of gain recognized under section
24 721(b) to the contributing owner at such time.

1 “(b) BASIS OF PROPERTY CONTRIBUTED TO PASS-
2 THROUGH.—The basis of property contributed to a pass-
3 through by an owner shall be the adjusted basis of such
4 property to the contributing owner at the time of the con-
5 tribution increased by the amount (if any) of gain recog-
6 nized under section 721(b) to the contributing owner at
7 such time.

8 **“SEC. 723. CHARACTER OF GAIN OR LOSS ON CONTRIB-**
9 **UTED UNREALIZED RECEIVABLES, INVEN-**
10 **TORY ITEMS, AND CAPITAL LOSS PROPERTY.**

11 “(a) CONTRIBUTIONS OF UNREALIZED RECEIVABLES
12 AND INVENTORY ITEMS.—In the case of any property
13 that—

14 “(1) was contributed to the passthrough by an
15 owner, and

16 “(2) was an unrealized receivable or inventory
17 item in the hands of such owner immediately before
18 such contribution,

19 any gain or loss recognized by the passthrough on the dis-
20 position of such property shall be treated as ordinary in-
21 come or ordinary loss, as the case may be.

22 “(b) CONTRIBUTIONS OF CAPITAL LOSS PROP-
23 ERTY.—In the case of any property that—

24 “(1) was contributed to the passthrough by an
25 owner, and

1 “(2) was a capital asset in the hands of such
2 owner immediately before such contribution,
3 any loss recognized by the passthrough on the disposition
4 of such property shall be treated as a loss from the sale
5 of a capital asset to the extent that, immediately before
6 such contribution, the adjusted basis of such property in
7 the hands of the owner exceeded the fair market value of
8 such property.

9 “(c) DEFINITIONS.—For purposes of this section—

10 “(1) UNREALIZED RECEIVABLE.—The term
11 ‘unrealized receivable’ has the meaning given such
12 term by section 751(c) (determined by treating any
13 reference to the passthrough as referring to the
14 owner).

15 “(2) INVENTORY ITEM.—The term ‘inventory
16 item’ has the meaning given such term by section
17 751(d) (determined by treating any reference to the
18 passthrough as referring to the owner and by apply-
19 ing section 1231 without regard to any holding pe-
20 riod therein provided).

21 “(3) SUBSTITUTED BASIS PROPERTY.—

22 “(A) IN GENERAL.—If any property de-
23 scribed in subsection (a) or (b) is disposed of in
24 a nonrecognition transaction, the tax treatment
25 that applies to such property under such sub-

1 section shall also apply to any substituted basis
2 property resulting from such transaction. A
3 similar rule shall also apply in the case of a se-
4 ries of nonrecognition transactions.

5 “(B) EXCEPTION FOR STOCK IN C COR-
6 PORATION.—Subparagraph (A) shall not apply
7 to any stock in a C corporation received in an
8 exchange described in section 351.

9 **“Subpart B—Distributions**

“Sec. 731. Extent of recognition of gain or loss on distribution.

“Sec. 732. Basis of distributed property other than money.

“Sec. 733. Basis of distributee owner’s passthrough interest.

“Sec. 734. Adjustment to basis of undistributed passthrough property.

“Sec. 735. Corresponding adjustment to basis of properties held by lower-tier
passthrough in case of upper-tier passthrough basis adjust-
ments.

10 **“SEC. 731. EXTENT OF RECOGNITION OF GAIN OR LOSS ON**
11 **DISTRIBUTION.**

12 “(a) OWNERS.—In the case of a distribution by a
13 passthrough to an owner—

14 “(1) AMOUNT APPLIED AGAINST BASIS.—The
15 fair market value of property, and the amount of
16 money, distributed shall not be included in the gross
17 income of such owner to the extent that it does not
18 exceed the adjusted basis of the owner’s passthrough
19 interest.

20 “(2) AMOUNT IN EXCESS OF BASIS.—If the fair
21 market value of property, and the amount of money,
22 distributed exceeds the adjusted basis of the owner’s

1 passthrough interest, such excess shall be treated as
2 gain from the sale or exchange of such passthrough
3 interest.

4 “(3) LIQUIDATION OF OWNER’S PASSTHROUGH
5 INTEREST.—In the case of the liquidation of the
6 owner’s passthrough interest—

7 “(A) paragraphs (1) and (2) shall apply to
8 any distribution in connection with such liq-
9 uidation, and

10 “(B) any loss on the termination of such
11 interest shall be treated as a loss from the sale
12 or exchange of such interest.

13 Notwithstanding subparagraph (B), no loss shall be
14 recognized on the termination of an owner’s pass-
15 through interest unless such termination constitutes
16 the termination of all direct and indirect interests of
17 the owner in the passthrough. Any loss not recog-
18 nized by reason of the preceding sentence shall be
19 recognized upon the termination of all such direct
20 and indirect interests.

21 “(b) PASSTHROUGHS.—

22 “(1) IN GENERAL.—Except as provided in para-
23 graph (2), no gain or loss shall be recognized to the
24 passthrough on a distribution to an owner of prop-
25 erty, including money.

1 “(B) such owner’s adjusted basis in the
2 passthrough determined immediately before
3 such distribution, plus

4 “(2) any gain recognized by such owner under
5 section 731(a)(2).

6 **“SEC. 733. BASIS OF DISTRIBUTE OWNER’S PASSTHROUGH**
7 **INTEREST.**

8 “In the case of a distribution by a passthrough to
9 an owner, the adjusted basis to such owner of his pass-
10 through interest shall be reduced (but not below zero)
11 by—

12 “(1) the amount of any money distributed to
13 such owner, and

14 “(2) the amount of the basis to such owner of
15 distributed property other than money, as deter-
16 mined under section 732.

17 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
18 **PASSTHROUGH PROPERTY.**

19 “(a) IN GENERAL.—In the case of any distribution
20 to an owner, the passthrough shall adjust the basis of
21 passthrough property such that each remaining owner’s
22 net liquidation amount immediately after such distribution
23 is equal to such owner’s net liquidation amount imme-
24 diately before such distribution (but after taking into ac-
25 count any gain recognized under section 731(b)).

1 “(b) DISTRIBUTIONS OTHER THAN IN LIQUIDATION
2 OF AN OWNER’S INTEREST.—In the case of any distribu-
3 tion to an owner other than in liquidation of such owner’s
4 interest, proper adjustment shall be made under sub-
5 section (a) with respect to such owner to take into ac-
6 count—

7 “(1) the amount of any gain recognized by such
8 owner with respect to such distribution under section
9 731(a), and

10 “(2) the amount of any loss which would be
11 recognized by such owner if such owner sold the
12 property distributed at fair market value imme-
13 diately after such distribution.

14 “(c) NET LIQUIDATION AMOUNT.—For purposes of
15 this section, the term ‘net liquidation amount’ means, with
16 respect to any owner, the net amount of gain or loss (if
17 any) which would be taken into account by the owner
18 under section 711 if the passthrough sold all of its assets
19 at fair market value (and no other amounts were taken
20 into account under such section).

21 “(d) ALLOCATION OF BASIS.—

22 “(1) DECREASES IN BASIS.—

23 “(A) IN GENERAL.—Any decrease in the
24 adjusted basis of passthrough property which is
25 required under this section—

1 “(i) shall be made first to properties
2 with unrealized depreciation in proportion
3 to their respective amounts of unrealized
4 depreciation before such decrease (but only
5 to the extent of each property’s unrealized
6 depreciation), and

7 “(ii) then, to the extent such decrease
8 is not allocated under clause (i), in propor-
9 tion to their respective adjusted bases (as
10 adjusted under clause (i)).

11 “(B) TREATMENT OF UNREALIZED RE-
12 CEIVABLES AND INVENTORY.—Clauses (i) and
13 (ii) shall each be applied first with respect to
14 property other than unrealized receivables (as
15 defined in section 751(c)) and inventory (as de-
16 fined in section 751(d)) to the extent thereof.

17 “(C) TREATMENT OF DECREASES IN EX-
18 CESS OF BASIS.—If any such decrease is pre-
19 vented by the absence of sufficient adjusted
20 basis of passthrough property, each owner shall
21 recognize gain in the amount of such owner’s
22 distributive share of such prevented decrease.
23 Such gain shall be treated as gain from the sale
24 of the owner’s passthrough interest.

25 “(2) INCREASES IN BASIS.—

1 “(A) IN GENERAL.—Any increase in the
2 adjusted basis of passthrough property which is
3 required under this section—

4 “(i) shall not be made with respect to
5 any unrealized receivable (as defined in
6 section 751(c)) or inventory (as defined in
7 section 751(d)) (and such property shall
8 not be taken into account under clauses
9 (ii) and (iii)),

10 “(ii) shall be made first to properties
11 with unrealized appreciation in proportion
12 to their respective amounts of unrealized
13 appreciation before such increase (but only
14 to the extent of each property’s unrealized
15 appreciation), and

16 “(iii) then, to the extent such increase
17 is not allocated under clause (ii), in pro-
18 portion to their respective fair market val-
19 ues.

20 “(B) TREATMENT OF INCREASE WHERE
21 LACK OF PROPERTY.—If any such increase is
22 prevented by the absence of property to which
23 clauses (ii) and (iii) of subparagraph (A) apply,
24 each owner shall recognize a loss in the amount
25 of such owner’s distributive share of such pre-

1 vented increase. Such loss shall be treated as a
2 loss from the sale of the owner's passthrough
3 interest.

4 “(e) NO ALLOCATION OF BASIS DECREASE TO
5 STOCK OF C CORPORATION OWNER.—In making an allo-
6 cation under subsection (d) of any decrease in the adjusted
7 basis of passthrough property required under subsection
8 (a)—

9 “(1) no allocation may be made to stock in a
10 C corporation (or any person related (within the
11 meaning of section 267(b) or 762(b)(1)) to such cor-
12 poration) which is an owner of the passthrough, and

13 “(2) any amount not allocable to stock by rea-
14 son of paragraph (1) shall be allocated under sub-
15 section (d) to other passthrough property.

16 Gain shall be recognized by the passthrough to the extent
17 that the amount required to be allocated to other pass-
18 through property under paragraph (2) exceeds the aggre-
19 gate adjusted basis of such other property immediately be-
20 fore the allocation required by subsection (a).

1 **“SEC. 735. CORRESPONDING ADJUSTMENT TO BASIS OF**
2 **PROPERTIES HELD BY LOWER-TIER PASS-**
3 **THROUGH IN CASE OF UPPER-TIER PASS-**
4 **THROUGH BASIS ADJUSTMENTS.**

5 “(a) DISTRIBUTIONS BY UPPER-TIER PASS-
6 THROUGH.—In the case of any distribution of property to
7 an owner by an upper-tier passthrough, if such distribu-
8 tion results in an adjustment in the upper-tier
9 passthrough’s adjusted basis in an interest in a lower-tier
10 passthrough under section 734, then such lower-tier pass-
11 through shall make a corresponding adjustment to the ad-
12 justed basis of its passthrough property.

13 “(b) DISTRIBUTIONS OF INTERESTS IN LOWER-TIER
14 PASSTHROUGH.—In the case of any distribution of an in-
15 terest in a lower-tier passthrough by an upper-tier pass-
16 through—

17 “(1) if the adjusted basis of such interest in the
18 hands of the upper-tier passthrough (determined im-
19 mediately before such distribution) exceeds the ad-
20 justed basis of such interest in the hands of the dis-
21 tributee owner (determined immediately after such
22 distribution), then such lower-tier passthrough shall
23 decrease the adjusted basis of its passthrough prop-
24 erty by the amount of such excess, or

25 “(2) if the adjusted basis of such interest in the
26 hands of the distributee owner (determined imme-

1 diately after such distribution) exceeds the adjusted
2 basis of such interest in the hands of the upper-tier
3 passthrough (determined immediately before such
4 distribution), then such lower-tier passthrough shall
5 increase the adjusted basis of its passthrough prop-
6 erty by the amount of such excess.

7 “(c) DISPOSITIONS OF INTERESTS IN UPPER-TIER
8 PASSTHROUGH.—In the case of a disposition of an inter-
9 est in an upper-tier passthrough which holds an interest
10 in a lower-tier passthrough, if there is an adjustment to
11 the adjusted basis of the lower-tier passthrough under sec-
12 tion 743, then such lower-tier passthrough shall make a
13 corresponding adjustment to the adjusted basis of its pass-
14 through property.

15 “(d) MULTI-TIERED PASSTHROUGHS.—In the case of
16 any adjustment under subsection (a), (b), or (c) in the
17 adjusted basis of an interest in another passthrough, such
18 other passthrough shall make a corresponding adjustment
19 in the adjusted basis of its passthrough property.

20 “(e) ALLOCATION OF BASIS; RECOGNITION OF
21 GAIN.—In the case of any adjustment in the adjusted
22 basis of passthrough property—

23 “(1) under subsection (a), (b), (c), or (d), such
24 adjustment shall be made only with respect to the
25 upper-tier passthrough’s proportionate share (as de-

1 terminated under section 743(a)) of the adjusted basis
2 of the lower-tier passthrough's property,

3 “(2) under subsection (a) or (b) (or so much of
4 subsection (d) as relates to either such subsection),
5 rules similar to the rules of section 734(d) shall
6 apply, and

7 “(3) under subsection (c) (or so much of sub-
8 section (d) as relates to such subsection), rules simi-
9 lar to the rules of section 743(b) shall apply.

10 “(f) REPORTING.—In the case of any adjustment in
11 the adjusted basis of passthrough property by a lower-tier
12 passthrough under this section by reason of a distribution
13 by, or a disposition of an interest in, an upper-tier pass-
14 through, such upper-tier passthrough shall furnish (in
15 such manner as the Secretary shall prescribe) to such
16 lower-tier passthrough such information as is necessary to
17 enable such lower-tier passthrough to make such adjust-
18 ment.

19 “(g) UPPER- AND LOWER-TIER PASSTHROUGHS.—
20 For purposes of this section—

21 “(1) UPPER-TIER PASSTHROUGH.—The term
22 ‘upper-tier passthrough’ means a passthrough own-
23 ing an interest in another passthrough.

24 “(2) LOWER-TIER PASSTHROUGH.—The term
25 ‘lower-tier passthrough’ means the passthrough re-

1 ferred to in paragraph (1) an interest in which is
2 owned by the upper-tier passthrough.

3 **“Subpart C—Transfers**

“Sec. 741. Recognition and character of gain or loss on sale or exchange.

“Sec. 742. Basis of transferee owner’s passthrough interest.

“Sec. 743. Adjustment to basis of passthrough property.

4 **“SEC. 741. RECOGNITION AND CHARACTER OF GAIN OR**
5 **LOSS ON SALE OR EXCHANGE.**

6 “(a) IN GENERAL.—In the case of a sale or exchange
7 of a passthrough interest, gain or loss shall be recognized
8 to the transferor owner. Such gain or loss shall be consid-
9 ered as gain or loss from the sale or exchange of a capital
10 asset, except as otherwise provided in section 723 or 751.

11 “(b) LIMITATION ON LOSSES.—Notwithstanding sub-
12 section (a), no loss shall be recognized on the sale, ex-
13 change, or other disposition of an owner’s passthrough in-
14 terest unless such disposition constitutes the disposition
15 of all direct and indirect interests of the owner in the pass-
16 through. Any loss not recognized by reason of the pre-
17 ceding sentence shall be recognized upon the termination
18 of all such direct and indirect interests.

19 **“SEC. 742. BASIS OF TRANSFEREE OWNER’S PASSTROUGH**
20 **INTEREST.**

21 “The basis of a passthrough interest acquired other
22 than by contribution shall be determined under part II of
23 subchapter O.

1 **“SEC. 743. ADJUSTMENT TO BASIS OF PASSTHROUGH PROP-**
2 **ERTY.**

3 “(a) IN GENERAL.—In the case of a transfer of a
4 passthrough interest by sale or exchange or upon the
5 death of an owner, a passthrough shall—

6 “(1) increase the adjusted basis of the pass-
7 through property by the excess of the basis to the
8 transferee owner of his passthrough interest over his
9 proportionate share of the adjusted basis of the
10 passthrough property, or

11 “(2) decrease the adjusted basis of the pass-
12 through property by the excess of the transferee
13 owner’s proportionate share of the adjusted basis of
14 the passthrough property over the basis of his pass-
15 through interest.

16 Under regulations prescribed by the Secretary, such in-
17 crease or decrease shall constitute an adjustment to the
18 basis of passthrough property with respect to the trans-
19 feree owner only. An owner’s proportionate share of the
20 adjusted basis of passthrough property shall be deter-
21 mined in accordance with his economic interest in the
22 passthrough and, in the case of property contributed to
23 the passthrough by an owner, section 712(d) (relating to
24 contributed property) shall apply in determining such
25 share. In the case of an adjustment under this subsection
26 to the basis of passthrough property subject to depletion,

1 any depletion allowable shall be determined separately for
2 the transferee owner with respect to his passthrough inter-
3 est in such property.

4 “(b) ALLOCATION OF BASIS.—

5 “(1) GENERAL RULE.—Any increase or de-
6 crease in the adjusted basis of passthrough property
7 under subsection (a) shall, except as provided in
8 paragraph (2), be allocated—

9 “(A) in a manner which has the effect of
10 reducing the difference between the fair market
11 value and the adjusted basis of passthrough
12 properties, or

13 “(B) in any other manner permitted by
14 regulations prescribed by the Secretary.

15 “(2) SPECIAL RULE.—In applying the allocation
16 rules provided in paragraph (1), increases or de-
17 creases in the adjusted basis of passthrough prop-
18 erty arising from a distribution of, or a transfer of
19 an interest attributable to, property consisting of—

20 “(A) capital assets and property described
21 in section 1231(b), or

22 “(B) any other property of the pass-
23 through,

1 shall be allocated to passthrough property of a like
2 character except that the basis of any such pass-
3 through property shall not be reduced below zero.

4 **“Subpart D—Other Provisions Relating to**
5 **Contributions, Distributions, and Transfers**

“Sec. 751. Unrealized receivables and inventory items.

“Sec. 752. Treatment of certain liabilities.

6 **“SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY**
7 **ITEMS.**

8 “(a) SALE OR EXCHANGE OF INTEREST IN PASS-
9 THROUGH.—The amount of any money, or the fair market
10 value of any property, received by a transferor owner in
11 exchange for all or a part of his passthrough interest at-
12 tributable to—

13 “(1) unrealized receivables of the passthrough,
14 or

15 “(2) inventory items of the passthrough,
16 shall be considered as an amount realized from the sale
17 or exchange of property other than a capital asset.

18 “(b) CERTAIN DISTRIBUTIONS TREATED AS SALES
19 OR EXCHANGES.—

20 “(1) IN GENERAL.—To the extent an owner re-
21 ceives in a distribution—

22 “(A) passthrough property which is—

23 “(i) unrealized receivables, or

24 “(ii) inventory items,

1 in exchange for all or a part of his interest in
2 other passthrough property (including money),
3 or

4 “(B) passthrough property (including
5 money) other than property described in sub-
6 paragraph (A)(i) or (ii) in exchange for all or
7 a part of his interest in passthrough property
8 described in subparagraph (A)(i) or (ii),

9 such transactions shall, under regulations prescribed
10 by the Secretary, be considered as a sale or ex-
11 change of such property between the distributee and
12 the passthrough (as constituted after the distribu-
13 tion).

14 “(2) EXCEPTIONS.—Paragraph (1) shall not
15 apply to a distribution of property which the dis-
16 tributee contributed to the passthrough.

17 “(c) UNREALIZED RECEIVABLES.—For purposes of
18 this subchapter, the term ‘unrealized receivables’ includes,
19 to the extent not previously includible in income under the
20 method of accounting used by the passthrough, any rights
21 (contractual or otherwise) to payment for—

22 “(1) goods delivered, or to be delivered, to the
23 extent the proceeds therefrom would be treated as
24 amounts received from the sale or exchange of prop-
25 erty other than a capital asset, or

1 “(2) services rendered, or to be rendered.

2 For purposes of this section and sections 731, 732, 735,
3 and 741, such term also includes any property other than
4 inventory items, but only to the extent of the amount
5 which would be treated as ordinary income if (at the time
6 of the transaction described in the applicable section) such
7 property had been sold by the passthrough for its fair
8 market value.

9 “(d) INVENTORY ITEMS.—For purposes of this sub-
10 chapter, the term ‘inventory items’ means—

11 “(1) property of the passthrough of the kind
12 described in section 1221(a)(1),

13 “(2) any other property of the passthrough
14 that, on sale or exchange by the passthrough, would
15 be considered property other than a capital asset
16 and other than property described in section 1231,
17 and

18 “(3) any other property held by the pass-
19 through that, if held by the selling or distributee
20 owner, would be considered property of the type de-
21 scribed in paragraph (1) or (2).

22 “(e) LIMITATION ON TAX ATTRIBUTABLE TO
23 DEEMED SALES OF SECTION 1248 STOCK.—For purposes
24 of applying this section and sections 731 and 741 to any
25 amount resulting from the reference to section 1248(a)

1 in the second sentence of subsection (c), in the case of
2 an individual, the tax attributable to such amount shall
3 be limited in the manner provided by subsection (b) of
4 section 1248 (relating to gain from certain sales or ex-
5 changes of stock in certain foreign corporation).

6 “(f) SPECIAL RULES IN THE CASE OF TIERED
7 PASSTHROUGHS, ETC.—In determining whether property
8 of a passthrough is—

9 “(1) an unrealized receivable, or

10 “(2) an inventory item,

11 such passthrough shall be treated as owning its propor-
12 tionate share of the property of any other passthrough in
13 which it is an owner. Under regulations, rules similar to
14 the rules of the preceding sentence shall also apply in the
15 case of interests in trusts.

16 **“SEC. 752. TREATMENT OF CERTAIN LIABILITIES.**

17 “(a) INCREASE IN OWNER’S LIABILITIES.—Any in-
18 crease in an owner’s share of the liabilities of a pass-
19 through, or any increase in an owner’s individual liabilities
20 by reason of the assumption by such owner of passthrough
21 liabilities, shall be considered as a contribution of money
22 by such owner to the passthrough.

23 “(b) DECREASE IN OWNER’S LIABILITIES.—Any de-
24 crease in an owner’s share of the liabilities of a pass-
25 through, or any decrease in an owner’s individual liabil-

ities by reason of the assumption by the passthrough of such individual liabilities, shall be considered as a distribution of money to the owner by the passthrough.

“(c) LIABILITY TO WHICH PROPERTY IS SUBJECT.—For purposes of this section, a liability to which property is subject shall, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

“(d) SALE OR EXCHANGE OF A PASSTHROUGH INTEREST.—In the case of a sale or exchange of a passthrough interest, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with passthroughs.

“PART IV—DEFINITIONS AND OTHER SPECIAL RULES

“Sec. 761. Definitions.

“Sec. 762. Transactions between owner and passthrough.

“Sec. 763. Taxable years of owner and passthrough.

“Sec. 764. Continuity of passthrough.

“Sec. 765. Distributions of passthrough interests treated as exchanges.

“SEC. 761. DEFINITIONS.

“(a) OWNER.—For purposes of this subchapter, the term ‘owner’ means a shareholder, partner, member, or person acting in a similar capacity with respect to a passthrough.

“(b) PASSTHROUGH INTEREST.—For purposes of this subchapter, the term ‘passthrough interest’ means an interest in the equity or profits of a passthrough.

1 “(c) PASSTHROUGH ITEM.—For purposes of this sub-
2 chapter, the term ‘passthrough item’ means each item,
3 contribution, and tax described in section 711(a) with re-
4 spect to which an owner may receive a distributive share.

5 “(d) DISTRIBUTIVE SHARE.—Notwithstanding any
6 other provision of this subchapter, an owner’s distributive
7 share (when expressed as a percentage)—

8 “(1) cannot be less than zero, and

9 “(2) must, when added to the distributive share
10 of all other owners, total 100 percent of the allo-
11 cated item.

12 “(e) OWNERSHIP AGREEMENT.—For purposes of this
13 subchapter, an ownership agreement includes any modi-
14 fications of the agreement made prior to, or at, the time
15 prescribed by law for the filing of the passthrough return
16 for the taxable year (not including extensions) which are
17 agreed to by all the owners, or which are adopted in such
18 other manner as may be provided by the agreement.

19 “(f) LIQUIDATION OF AN OWNER’S PASSTHROUGH
20 INTEREST.—For purposes of this subchapter, the term
21 ‘liquidation of an owner’s passthrough interest’ means the
22 termination of an owner’s entire passthrough interest by
23 means of a distribution, or a series of distributions, to the
24 owner by the passthrough.

1 “(iii) the performance of such services
2 (or such transfer) and the distribution,
3 when viewed together, are properly charac-
4 terized as a transaction occurring between
5 the passthrough and an owner acting other
6 than in his capacity as an owner of the
7 passthrough,
8 such allocation and distribution shall be treated
9 as transaction described in paragraph (1).

10 “(B) TREATMENT OF CERTAIN PROPERTY
11 TRANSFERS.—If—

12 “(i) there is a direct or indirect trans-
13 fer of money or other property by an
14 owner to a passthrough,

15 “(ii) there is a related direct or indi-
16 rect transfer of money or other property by
17 the passthrough to the owner (or another
18 owner), and

19 “(iii) the transfers described in
20 clauses (i) and (ii), when viewed together,
21 are properly characterized as a sale or ex-
22 change of property,

23 such transfers shall be treated either as a
24 transaction described in paragraph (1) or as a
25 transaction between 2 or more owners acting

1 other than in their capacity as owners of the
2 passthrough.

3 “(3) OWNERS ACTING AS EMPLOYEES.—Any
4 reasonable compensation, including wages, for serv-
5 ices provided by an owner shall be treated as a
6 transaction described in paragraph (1).

7 “(b) CERTAIN SALES OR EXCHANGES OF PROPERTY
8 WITH RESPECT TO CONTROLLED PASSTHROUGH.—

9 “(1) LOSSES DISALLOWED.—No deduction shall
10 be allowed in respect of losses from sales or ex-
11 changes of property (other than an interest in the
12 passthrough), directly or indirectly, between—

13 “(A) a passthrough and a person owning,
14 directly or indirectly, more than 50 percent of
15 the interest in such passthrough, or

16 “(B) two passthroughs in which the same
17 persons own, directly or indirectly, more than
18 50 percent of the passthrough interests.

19 In the case of a subsequent sale or exchange by a
20 transferee described in this paragraph, section
21 267(d) shall be applicable as if the loss were dis-
22 allowed under section 267(a)(1). For purposes of
23 section 267(a)(2), passthroughs described in sub-
24 paragraph (B) of this paragraph shall be treated as
25 persons specified in section 267(b).

1 “(2) GAINS TREATED AS ORDINARY INCOME.—
2 In the case of a sale or exchange, directly or indi-
3 rectly, of property, which, in the hands of the trans-
4 feree, is property other than a capital asset as de-
5 fined in section 1221—

6 “(A) between a passthrough and a person
7 owning, directly or indirectly, more than 50
8 percent of the passthrough interest, or

9 “(B) between two passthroughs in which
10 the same persons own, directly or indirectly,
11 more than 50 percent of the passthrough inter-
12 est,

13 any gain recognized shall be considered as ordinary
14 income.

15 “(3) OWNERSHIP OF A PASSTHROUGH INTER-
16 EST.—For purposes of paragraphs (1) and (2) of
17 this subsection, the ownership of a passthrough in-
18 terest shall be determined in accordance with the
19 rules for constructive ownership of stock provided in
20 section 267(c).

21 **“SEC. 763. TAXABLE YEARS OF OWNER AND PASSTHROUGH.**

22 “(a) YEAR IN WHICH PASSTHROUGH INCOME IS IN-
23 CLUDIBLE.—In computing the taxable income of an owner
24 for a taxable year, the inclusions required by section 711
25 with respect to a passthrough shall be based on the pass-

1 through items of the passthrough for any taxable year of
2 the passthrough ending within or with the taxable year
3 of the owner.

4 “(b) TAXABLE YEAR OF A PASSTHROUGH.—

5 “(1) PASSTHROUGH TAXABLE YEAR.—

6 “(A) GENERAL RULE.—For purposes of
7 this subtitle, the taxable year of a passthrough
8 shall be a permitted year.

9 “(B) PERMITTED YEAR DEFINED.—For
10 purposes of this section, the term ‘permitted
11 year’ means a taxable year which—

12 “(i) is a year ending December 31, or

13 “(ii) is any other accounting period
14 for which the passthrough establishes a
15 business purpose to the satisfaction of the
16 Secretary.

17 For purposes of subparagraph (B), any deferral
18 of income to owners shall not be treated as a
19 business purpose.

20 “(2) OWNER’S TAXABLE YEAR.—

21 “(A) GENERAL RULE.—An owner may not
22 change to a taxable year other than that of a
23 passthrough in which he is a principal owner
24 unless he establishes, to the satisfaction of the
25 Secretary, a business purpose therefor.

1 “(B) PRINCIPAL OWNER.—For the purpose
2 of this subsection, a principal owner is an
3 owner having a passthrough interest of 5 per-
4 cent or more.

5 “(c) CLOSING OF PASSTHROUGH YEAR.—

6 “(1) GENERAL RULE.—Except in the case of a
7 termination of a passthrough and except as provided
8 in paragraph (2) of this subsection, the taxable year
9 of a passthrough shall not close as the result of the
10 death of an owner, the entry of a new owner, the liq-
11 uidation of an owner’s passthrough interest, or the
12 sale or exchange of an owner’s passthrough interest.

13 “(2) TREATMENT OF DISPOSITIONS.—

14 “(A) DISPOSITION OF ENTIRE PASS-
15 THROUGH INTEREST.—The taxable year of a
16 passthrough shall close with respect to an
17 owner whose entire passthrough interest termi-
18 nates (whether by reason of death, liquidation,
19 or otherwise).

20 “(B) DISPOSITION OF LESS THAN ENTIRE
21 PASSTHROUGH INTEREST.—The taxable year of
22 a passthrough shall not close (other than at the
23 end of a passthrough’s taxable year as deter-
24 mined under subsection (b)(1)) with respect to
25 an owner who sells or exchanges less than his

1 entire passthrough interest or with respect to
2 an owner whose passthrough interest is reduced
3 (whether by entry of a new owner, partial liq-
4 uidation of an owner's passthrough interest,
5 gift, or otherwise).

6 “(d) DETERMINATION OF DISTRIBUTIVE SHARE
7 WHEN OWNER'S INTEREST CHANGES.—

8 “(1) IN GENERAL.—Except as provided in para-
9 graphs (2) and (3), if during any taxable year of the
10 passthrough there is a change in any owner's inter-
11 est in the passthrough, each owner's distributive
12 share of any item of income, gain, loss, deduction,
13 or credit of the passthrough for such taxable year
14 shall be determined by the use of any method pre-
15 scribed by the Secretary by regulations which takes
16 into account the varying interests of the owners in
17 the passthrough during such taxable year.

18 “(2) CERTAIN CASH BASIS ITEMS PRORATED
19 OVER PERIOD TO WHICH ATTRIBUTABLE.—

20 “(A) IN GENERAL.—If during any taxable
21 year of the passthrough there is a change in
22 any owner's interest in the passthrough, then
23 (except to the extent provided in regulations)
24 each owner's distributive share of any allocable
25 cash basis item shall be determined—

1 “(i) by assigning the appropriate por-
2 tion of such item to each day in the period
3 to which it is attributable, and

4 “(ii) by allocating the portion as-
5 signed to any such day among the owners
6 in proportion to their interests in the pass-
7 through at the close of such day.

8 “(B) ALLOCABLE CASH BASIS ITEM.—For
9 purposes of this paragraph, the term ‘allocable
10 cash basis item’ means any of the following
11 items with respect to which the passthrough
12 uses the cash receipts and disbursements meth-
13 od of accounting:

14 “(i) Interest.

15 “(ii) Taxes.

16 “(iii) Payments for services or for the
17 use of property.

18 “(iv) Any other item of a kind speci-
19 fied in regulations prescribed by the Sec-
20 retary as being an item with respect to
21 which the application of this paragraph is
22 appropriate to avoid significant
23 misstatements of the income of the owners.

24 “(C) ITEMS ATTRIBUTABLE TO PERIODS
25 NOT WITHIN TAXABLE YEAR.—If any portion of

1 any allocable cash basis item is attributable
2 to—

3 “(i) any period before the beginning
4 of the taxable year, such portion shall be
5 assigned under subparagraph (A)(i) to the
6 first day of the taxable year, or

7 “(ii) any period after the close of the
8 taxable year,

9 such portion shall be assigned under subpara-
10 graph (A)(i) to the last day of the taxable year.

11 “(D) TREATMENT OF DEDUCTIBLE ITEMS
12 ATTRIBUTABLE TO PRIOR PERIODS.—If any
13 portion of a deductible cash basis item is as-
14 signed under subparagraph (C)(i) to the first
15 day of any taxable year—

16 “(i) such portion shall be allocated
17 among persons who are owners in the
18 passthrough during the period to which
19 such portion is attributable in accordance
20 with their varying interests in the pass-
21 through during such period, and

22 “(ii) any amount allocated under
23 clause (i) to a person who is not an owner
24 in the passthrough on such first day shall
25 be capitalized by the passthrough and

1 treated in the manner provided for in sec-
2 tion 743(b).

3 “(3) ITEMS ATTRIBUTABLE TO INTEREST IN
4 LOWER-TIER PASSTHROUGH PRORATED OVER EN-
5 TIRE TAXABLE YEAR.—If—

6 “(A) during any taxable year of the pass-
7 through there is a change in any owner’s inter-
8 est in the passthrough (hereinafter in this para-
9 graph referred to as the ‘upper-tier pass-
10 through’), and

11 “(B) such passthrough is an owner in an-
12 other passthrough (hereinafter in this para-
13 graph referred to as the ‘lower-tier pass-
14 through’),

15 then (except to the extent provided in regulations)
16 each owner’s distributive share of any item of the
17 upper-tier passthrough attributable to the lower-tier
18 passthrough shall be determined by assigning the
19 appropriate portion (determined by applying prin-
20 ciples similar to the principles of subparagraphs (C)
21 and (D) of paragraph (2)) of each such item to the
22 appropriate days during which the upper-tier pass-
23 through is an owner in the lower-tier passthrough
24 and by allocating the portion assigned to any such
25 day among the owners in proportion to their inter-

1 ests in the upper-tier passthrough at the close of
2 such day.

3 “(4) TAXABLE YEAR DETERMINED WITHOUT
4 REGARD TO SUBSECTION (C)(2)(A).—For purposes of
5 this subsection, the taxable year of a passthrough
6 shall be determined without regard to subsection
7 (c)(2)(A).

8 **“SEC. 764. CONTINUITY OF PASSTHROUGH.**

9 “(a) GENERAL RULE.—For purposes of this sub-
10 chapter, an existing passthrough shall be considered as
11 continuing if it is not terminated.

12 “(b) TERMINATION.—

13 “(1) GENERAL RULE.—For purposes of sub-
14 section (a), a passthrough shall be considered as ter-
15 minated only if—

16 “(A) no part of any business, financial op-
17 eration, or venture of the passthrough continues
18 to be carried on by any of its owners in a pass-
19 through, or

20 “(B) within a 12-month period there is a
21 sale or exchange of 50 percent or more of the
22 passthrough interests.

23 “(2) SPECIAL RULES.—

24 “(A) MERGER OR CONSOLIDATION.—In the
25 case of the merger or consolidation of two or

1 more passthroughs, the resulting passthrough
2 shall, for purposes of this section, be considered
3 the continuation of any merging or consoli-
4 dating passthrough whose owners possess a
5 passthrough interest of more than 50 percent of
6 the resulting passthrough.

7 “(B) DIVISION OF A PASSTHROUGH.—In
8 the case of a division of a passthrough into two
9 or more passthroughs, the resulting
10 passthroughs (other than any resulting pass-
11 through the owners of which had a passthrough
12 interest of 50 percent or less of the prior pass-
13 through) shall, for purposes of this section, be
14 considered a continuation of the prior pass-
15 through.

16 **“SEC. 765. DISTRIBUTIONS OF PASSTHROUGH INTERESTS**
17 **TREATED AS EXCHANGES.**

18 “Except as otherwise provided in regulations, for pur-
19 poses of—

20 “(1) subsections (a) and (b) of section 743,

21 “(2) section 764, and

22 “(3) any other provision of this subchapter
23 specified in regulations prescribed by the Secretary,
24 any distribution of a passthrough interest (not otherwise
25 treated as an exchange) shall be treated as an exchange.

1 **“PART V—RULES RELATING TO PASSTHROUGH**
2 **CORPORATIONS**

“Sec. 771. Coordination with subchapter C.

“Sec. 772. Treatment of distributions of passthrough corporations with accumulated earning and profits.

“Sec. 773. Tax imposed on certain built-in gains.

“Sec. 774. Tax imposed when passive investment income of corporation having accumulated earnings and profits exceeds 60 percent of gross receipts.

“Sec. 775. Recapture of LIFO benefits.

“Sec. 776. Application of passthrough corporation rules to pre-existing S corporations.

3 **“SEC. 771. COORDINATION WITH SUBCHAPTER C.**

4 “(a) SUBCHAPTER C RULES GENERALLY INAPPLI-
5 CABLE.—Subchapter C shall not apply to a passthrough
6 corporation and its shareholders.

7 “(b) NO CARRYOVER BETWEEN C YEAR AND PASS-
8 THROUGH YEAR.—

9 “(1) FROM C YEAR TO PASSTHROUGH YEAR.—
10 No carryforward, and no carryback, arising for a
11 taxable year for which a corporation is a C corpora-
12 tion may be carried to a taxable year for which such
13 corporation is a passthrough corporation.

14 “(2) NO CARRYOVER FROM PASSTHROUGH
15 YEAR.—No carryforward, and no carryback, shall
16 arise at the corporate level for a taxable year for
17 which a corporation is a passthrough corporation.

18 “(3) TREATMENT OF PASSTHROUGH YEAR AS
19 ELAPSED YEAR.—Nothing in paragraphs (1) and (2)
20 shall prevent treating a taxable year for which a cor-

1 poration is a passthrough corporation as a taxable
2 year for purposes of determining the number of tax-
3 able years to which an item may be carried back or
4 carried forward.

5 “(c) COORDINATION WITH INVESTMENT CREDIT RE-
6 CAPTURE.—

7 “(1) NO RECAPTURE BY REASON OF ELEC-
8 TION.—Any election under section 703(a) shall be
9 treated as a mere change in the form of conducting
10 a trade or business for purposes of the second sen-
11 tence of section 50(a)(4).

12 “(2) CORPORATION CONTINUES TO BE LIA-
13 BLE.—Notwithstanding an election under section
14 703(a), a passthrough corporation shall continue to
15 be liable for any increase in tax under section 49(b)
16 or 50(a) attributable to credits allowed for taxable
17 years for which such corporation was not a pass-
18 through corporation.

19 “(d) CASH DISTRIBUTIONS DURING POST-TERMI-
20 NATION TRANSITION PERIOD.—

21 “(1) IN GENERAL.—Any distribution of money
22 by a C corporation with respect to its stock during
23 a post-termination transition period shall be applied
24 against and reduce the adjusted basis of the stock,
25 to the extent that the amount of the distribution

1 does not exceed the accumulated adjustments ac-
2 count (within the meaning of section 772).

3 “(2) ELECTION TO DISTRIBUTE EARNINGS
4 FIRST.—A corporation may elect to have paragraph
5 (1) not apply to all distributions made during a
6 post-termination transition period described in sub-
7 section (f)(1)(A). Such election shall not be effective
8 unless all shareholders of the corporation to whom
9 distributions are made by the corporation during
10 such post-termination transition period consent to
11 such election.

12 “(e) POST-TERMINATION TRANSITION PERIOD.—

13 “(1) IN GENERAL.—For purposes of this sec-
14 tion, the term ‘post-termination transition period’
15 means—

16 “(A) the period beginning on the day after
17 the last day of the corporation’s last taxable
18 year as a passthrough corporation and ending
19 on the later of—

20 “(i) the day which is 1 year after such
21 last day, or

22 “(ii) the due date for filing the return
23 for such last year as a passthrough cor-
24 poration (including extensions),

1 “(B) the 120-day period beginning on the
2 date of any determination pursuant to an audit
3 of the taxpayer which follows the termination of
4 the corporation’s election and which adjusts an
5 item of income, gain, loss, deduction, or credit
6 of the corporation arising during the pass-
7 through period (as defined in section
8 772(d)(2)), and

9 “(C) the 120-day period beginning on the
10 date of a determination that the corporation’s
11 election under section 703(a) had terminated
12 for a previous taxable year.

13 “(2) DETERMINATION DEFINED.— For pur-
14 poses of paragraph (1), the term ‘determination’
15 means—

16 “(A) a determination as defined in section
17 1313(a), or

18 “(B) an agreement between the corpora-
19 tion and the Secretary that the corporation
20 failed to qualify as a passthrough corporation.

21 “(3) SPECIAL RULE FOR AUDIT RELATED POST-
22 TERMINATION TRANSITION PERIODS.—Paragraph
23 (1)(B) shall apply to a distribution described in sub-
24 section (e) only to the extent that the amount of
25 such distribution does not exceed the aggregate in-

1 crease (if any) in the accumulated adjustments ac-
2 count (within the meaning of section 772(d)) by rea-
3 son of the adjustments referred to in such para-
4 graph.

5 **“SEC. 772. TREATMENT OF DISTRIBUTIONS OF PASS-**
6 **THROUGH CORPORATIONS WITH ACCUMU-**
7 **LATED EARNING AND PROFITS.**

8 “(a) IN GENERAL.—Notwithstanding section 731, in
9 the case of a distribution (to which, but for section 771(a),
10 section 301 would apply) by a passthrough corporation
11 which has accumulated earnings and profits, that portion
12 of the distribution which—

13 “(1) exceeds the accumulated adjustments ac-
14 count, and

15 “(2) does not exceed the accumulated earnings
16 and profits of the corporation,
17 shall be treated as a dividend.

18 “(b) ALLOCATION.—Except to the extent provided in
19 regulations, if the distributions during the taxable year ex-
20 ceed the amount in the accumulated adjustments account
21 at the close of the taxable year, for purposes of this sec-
22 tion, the balance of such account shall be allocated among
23 such distributions in proportion to their respective sizes.

1 “(c) CERTAIN ADJUSTMENTS TAKEN INTO AC-
2 COUNT.—Subsection (a) shall be applied by properly tak-
3 ing into account—

4 “(1) the adjustments to the basis of the share-
5 holder’s stock described in section 713, and

6 “(2) the adjustments to the accumulated ad-
7 justments account which are required by subsection
8 (d)(1).

9 In the case of any distribution made during any taxable
10 year, the adjusted basis of the stock shall be determined
11 with regard to the adjustments provided in section 713(1)
12 for the taxable year.

13 “(d) DEFINITIONS AND SPECIAL RULES.—For pur-
14 poses of this section—

15 “(1) ACCUMULATED ADJUSTMENTS AC-
16 COUNT.—

17 “(A) IN GENERAL.—Except as otherwise
18 provided in this subparagraph, the term ‘accu-
19 mulated adjustments account’ means an ac-
20 count of the passthrough corporation which is
21 adjusted for the passthrough period in a man-
22 ner similar to the adjustments under section
23 713 (except that no adjustment shall be made
24 for income (and related expenses) which is ex-
25 empt from tax under this title and the phrase

1 ‘(but not below zero)’ shall be disregarded in
2 section 713(2) and no adjustment shall be made
3 for Federal taxes attributable to any taxable
4 year in which the corporation was a C corpora-
5 tion.

6 “(B) NET LOSS FOR YEAR DIS-
7 REGARDED.—

8 “(i) IN GENERAL.—In applying this
9 section to distributions made during any
10 taxable year, the amount in the accumu-
11 lated adjustments account as of the close
12 of such taxable year shall be determined
13 without regard to any net negative adjust-
14 ment for such taxable year.

15 “(ii) NET NEGATIVE ADJUSTMENT.—
16 For purposes of clause (i), the term ‘net
17 negative adjustment’ means, with respect
18 to any taxable year, the excess (if any)
19 of—

20 “(I) the reductions in the ac-
21 count for the taxable year (other than
22 for distributions), over

23 “(II) the increases in such ac-
24 count for such taxable year.

1 “(2) ACCUMULATED EARNINGS AND PROFITS.—

2 The term ‘accumulated earnings and profits’ means
3 the accumulated earnings and profits (if any) deter-
4 mined as of the close of the last taxable year for
5 which the corporation was a C corporation, reduced
6 by any amounts treated as dividends under sub-
7 section (a) and adjusted for any increase in tax
8 under section 49(b) or 50(a) for which the pass-
9 through is liable under section 771(c)(2).

10 “(3) PASSTHROUGH PERIOD.— The term ‘pass-
11 through period’ means the most recent continuous
12 period during which the corporation has been a pass-
13 through corporation. Such period shall not include
14 any taxable year beginning before January 1, 1983.

15 “(4) ELECTION TO DISTRIBUTE EARNINGS
16 FIRST.—

17 “(A) IN GENERAL.—A passthrough cor-
18 poration may, with the consent of all of its af-
19 fected shareholders, elect to have subsection (a)
20 applied without regard to paragraph (1) thereof
21 with respect to all distributions made during
22 the taxable year for which the election is made.

23 “(B) AFFECTED SHAREHOLDER.—For
24 purposes of subparagraph (A), the term ‘af-
25 fected shareholder’ means any shareholder to

1 whom a distribution is made by the pass-
2 through corporation during the taxable year.

3 **“SEC. 773. TAX IMPOSED ON CERTAIN BUILT-IN GAINS.**

4 “(a) GENERAL RULE.—If for any taxable year begin-
5 ning in the recognition period a passthrough corporation
6 has a net recognized built-in gain, there is hereby imposed
7 a tax (computed under subsection (b)) on the income of
8 such corporation for such taxable year.

9 “(b) AMOUNT OF TAX.—

10 “(1) IN GENERAL.—The amount of the tax im-
11 posed by subsection (a) shall be computed by apply-
12 ing the highest rate of tax specified in section 11(b)
13 to the net recognized built-in gain of the pass-
14 through corporation for the taxable year.

15 “(2) NET OPERATING LOSS CARRYFORWARDS
16 FROM C YEARS ALLOWED.—Notwithstanding section
17 771(b)(1), any net operating loss carryforward aris-
18 ing in a taxable year for which the corporation was
19 a C corporation shall be allowed for purposes of this
20 section as a deduction against the net recognized
21 built-in gain of the passthrough corporation for the
22 taxable year. For purposes of determining the
23 amount of any such loss which may be carried to
24 subsequent taxable years, the amount of the net rec-
25 ognized built-in gain shall be treated as taxable in-

1 come. Rules similar to the rules of the preceding
2 sentences of this paragraph shall apply in the case
3 of a capital loss carryforward arising in a taxable
4 year for which the corporation was a C corporation.

5 “(3) CREDITS.—

6 “(A) IN GENERAL.—Except as provided in
7 subparagraph (B), no credit shall be allowable
8 under part IV of subchapter A of this chapter
9 (other than under section 34) against the tax
10 imposed by subsection (a).

11 “(B) BUSINESS CREDIT CARRYFORWARDS
12 FROM C YEARS ALLOWED.—Notwithstanding
13 section 771(b)(1), any business credit
14 carryforward under section 39 arising in a tax-
15 able year for which the corporation was a C
16 corporation shall be allowed as a credit against
17 the tax imposed by subsection (a) in the same
18 manner as if it were imposed by section 11. A
19 similar rule shall apply in the case of the min-
20 imum tax credit under section 53 to the extent
21 attributable to taxable years for which the cor-
22 poration was a C corporation.

23 “(4) COORDINATION WITH SECTION 1201(A).—

24 For purposes of section 1201(a)—

1 “(A) the tax imposed by subsection (a)
2 shall be treated as if it were imposed by section
3 11, and

4 “(B) the amount of the net recognized
5 built-in gain shall be treated as the taxable in-
6 come.

7 “(c) LIMITATIONS.—

8 “(1) CORPORATIONS WHICH WERE ALWAYS
9 PASSTHROUGH CORPORATIONS.—Subsection (a) shall
10 not apply to any corporation if an election under
11 section 703(a) has been in effect with respect to
12 such corporation for each of its taxable years. Ex-
13 cept as provided in regulations, a passthrough cor-
14 poration and any predecessor corporation shall be
15 treated as 1 corporation for purposes of the pre-
16 ceding sentence.

17 “(2) LIMITATION ON AMOUNT OF NET RECOG-
18 NIZED BUILT-IN GAIN.—The amount of the net rec-
19 ognized built-in gain taken into account under this
20 section for any taxable year shall not exceed the ex-
21 cess (if any) of—

22 “(A) the net unrealized built-in gain, over

23 “(B) the net recognized built-in gain for
24 prior taxable years beginning in the recognition
25 period.

1 “(d) DEFINITIONS AND SPECIAL RULES.—For pur-
2 poses of this section—

3 “(1) NET UNREALIZED BUILT-IN GAIN.—The
4 term ‘net unrealized built-in gain’ means the amount
5 (if any) by which—

6 “(A) the fair market value of the assets of
7 the passthrough corporation as of the beginning
8 of its 1st taxable year for which an election
9 under section 703 is in effect, exceeds

10 “(B) the aggregate adjusted bases of such
11 assets at such time.

12 “(2) NET RECOGNIZED BUILT-IN GAIN.—

13 “(A) IN GENERAL.—The term ‘net recog-
14 nized built-in gain’ means, with respect to any
15 taxable year in the recognition period, the lesser
16 of—

17 “(i) the amount which would be the
18 taxable income of the passthrough corpora-
19 tion for such taxable year if only recog-
20 nized built-in gains and recognized built-in
21 losses were taken into account, or

22 “(ii) such corporation’s taxable in-
23 come for such taxable year (determined as
24 provided in section 774(b)(1)(B)).

1 “(B) CARRYOVER.—If, for any taxable
2 year described in subparagraph (A), the amount
3 referred to in clause (i) of subparagraph (A) ex-
4 ceeds the amount referred to in clause (ii) of
5 subparagraph (A), such excess shall be treated
6 as a recognized built-in gain in the succeeding
7 taxable year. The preceding sentence shall not
8 apply in the case of a corporation treated as a
9 passthrough corporation under section 776 by
10 reason of an election made before March 31,
11 1988.

12 “(3) RECOGNIZED BUILT-IN GAIN.—The term
13 ‘recognized built-in gain’ means any gain recognized
14 during the recognition period on the disposition of
15 any asset except to the extent that the passthrough
16 corporation establishes that—

17 “(A) such asset was not held by the pass-
18 through corporation as of the beginning of the
19 1st taxable year for which it was a passthrough
20 corporation, or

21 “(B) such gain exceeds the excess (if any)
22 of—

23 “(i) the fair market value of such
24 asset as of the beginning of such 1st tax-
25 able year, over

1 “(ii) the adjusted basis of the asset as
2 of such time.

3 “(4) RECOGNIZED BUILT-IN LOSSES.—The
4 term ‘recognized built-in loss’ means any loss recog-
5 nized during the recognition period on the disposi-
6 tion of any asset to the extent that the passthrough
7 corporation establishes that—

8 “(A) such asset was held by the pass-
9 through corporation as of the beginning of the
10 1st taxable year referred to in paragraph (3),
11 and

12 “(B) such loss does not exceed the excess
13 of—

14 “(i) the adjusted basis of such asset
15 as of the beginning of such 1st taxable
16 year, over

17 “(ii) the fair market value of such
18 asset as of such time.

19 “(5) TREATMENT OF CERTAIN BUILT-IN
20 ITEMS.—

21 “(A) INCOME ITEMS.—Any item of income
22 which is properly taken into account during the
23 recognition period but which is attributable to
24 periods before the 1st taxable year for which
25 the corporation was a passthrough corporation

1 shall be treated as a recognized built-in gain for
2 the taxable year in which it is properly taken
3 into account.

4 “(B) DEDUCTION ITEMS.—Any amount
5 which is allowable as a deduction during the
6 recognition period (determined without regard
7 to any carryover) but which is attributable to
8 periods before the 1st taxable year referred to
9 in subparagraph (A) shall be treated as a recog-
10 nized built-in loss for the taxable year for which
11 it is allowable as a deduction.

12 “(C) ADJUSTMENT TO NET UNREALIZED
13 BUILT-IN GAIN.—The amount of the net unreal-
14 ized built-in gain shall be properly adjusted for
15 amounts which would be treated as recognized
16 built-in gains or losses under this paragraph if
17 such amounts were properly taken into account
18 (or allowable as a deduction) during the rec-
19 ognition period.

20 “(6) TREATMENT OF CERTAIN PROPERTY.—If
21 the adjusted basis of any asset is determined (in
22 whole or in part) by reference to the adjusted basis
23 of any other asset held by the passthrough corpora-
24 tion as of the beginning of the 1st taxable year re-
25 ferred to in paragraph (3)—

1 “(A) such asset shall be treated as held by
2 the passthrough corporation as of the beginning
3 of such 1st taxable year, and

4 “(B) any determination under paragraph
5 (3)(B) or (4)(B) with respect to such asset
6 shall be made by reference to the fair market
7 value and adjusted basis of such other asset as
8 of the beginning of such 1st taxable year.

9 “(7) RECOGNITION PERIOD.—

10 “(A) IN GENERAL.—The term ‘recognition
11 period’ means the 5-year period beginning with
12 the 1st day of the 1st taxable year for which
13 the corporation was a passthrough corporation.
14 For purposes of applying this section to any
15 amount includible in income by reason of dis-
16 tributions to shareholders pursuant to section
17 593(e), the preceding sentence shall be applied
18 without regard to the phrase ‘5-year’.

19 “(B) INSTALLMENT SALES.—If a pass-
20 through corporation sells an asset and reports
21 the income from the sale using the installment
22 method under section 453, the treatment of all
23 payments received shall be governed by the pro-
24 visions of this paragraph applicable to the tax-
25 able year in which such sale was made.

1 “(8) TREATMENT OF TRANSFER OF ASSETS
2 FROM C CORPORATION TO PASSTHROUGH CORPORA-
3 TION.—

4 “(A) IN GENERAL.—Except to the extent
5 provided in regulations, if—

6 “(i) a passthrough corporation ac-
7 quires any asset, and

8 “(ii) the passthrough corporation’s
9 basis in such asset is determined (in whole
10 or in part) by reference to the basis of
11 such asset (or any other property) in the
12 hands of a C corporation,

13 then a tax is hereby imposed on any net recog-
14 nized built-in gain attributable to any such as-
15 sets for any taxable year beginning in the rec-
16 ognition period. The amount of such tax shall
17 be determined under the rules of this section as
18 modified by subparagraph (B).

19 “(B) MODIFICATIONS.—For purposes of
20 this paragraph, the modifications of this sub-
21 paragraph are as follows:

22 “(i) IN GENERAL.—The preceding
23 paragraphs of this subsection shall be ap-
24 plied by taking into account the day on
25 which the assets were acquired by the

1 passthrough corporation in lieu of the be-
2 ginning of the 1st taxable year for which
3 the corporation was a passthrough cor-
4 poration.

5 “(ii) SUBSECTION (C)(1) NOT TO
6 APPLY.—Subsection (c)(1) shall not apply.

7 “(9) REFERENCE TO 1ST TAXABLE YEAR.—Any
8 reference in this section to the 1st taxable year for
9 which the corporation was a passthrough corporation
10 shall be treated as a reference to the 1st taxable
11 year for which the corporation was a passthrough
12 corporation pursuant to its most recent election
13 under section 703(a).

14 “(e) REGULATIONS.—The Secretary shall prescribe
15 such regulations as may be necessary to carry out the pur-
16 poses of this section including regulations providing for
17 the appropriate treatment of successor corporations.

18 **“SEC. 774. TAX IMPOSED WHEN PASSIVE INVESTMENT IN-**
19 **COME OF CORPORATION HAVING ACCUMU-**
20 **LATED EARNINGS AND PROFITS EXCEEDS 60**
21 **PERCENT OF GROSS RECEIPTS.**

22 “(a) GENERAL RULE.—If for the taxable year a pass-
23 through corporation has—

24 “(1) accumulated earnings and profits at the
25 close of such taxable year, and

1 “(2) gross receipts more than 60 percent of
2 which are passive investment income,
3 then there is hereby imposed a tax on the income of such
4 corporation for such taxable year. Such tax shall be com-
5 puted by multiplying the excess net passive income by the
6 highest rate of tax specified in section 11(b).

7 “(b) DEFINITIONS.—For purposes of this section—

8 “(1) EXCESS NET PASSIVE INCOME.—

9 “(A) IN GENERAL.—Except as provided in
10 subparagraph (B), the term ‘excess net passive
11 income’ means an amount which bears the same
12 ratio to the net passive income for the taxable
13 year as—

14 “(i) the amount by which the passive
15 investment income for the taxable year ex-
16 ceeds 60 percent of the gross receipts for
17 the taxable year, bears to

18 “(ii) the passive investment income
19 for the taxable year.

20 “(B) LIMITATION.—The amount of the ex-
21 cess net passive income for any taxable year
22 shall not exceed the amount of the corporation’s
23 taxable income for such taxable year as deter-
24 mined under section 63(a)—

1 “(i) without regard to the deductions
2 allowed by part VIII of subchapter B
3 (other than the deduction allowed by sec-
4 tion 248, relating to organization expendi-
5 tures), and

6 “(ii) without regard to the deduction
7 under section 172.

8 “(2) NET PASSIVE INCOME.—The term ‘net
9 passive income’ means—

10 “(A) passive investment income, reduced
11 by

12 “(B) the deductions allowable under this
13 chapter which are directly connected with the
14 production of such income (other than deduc-
15 tions allowable under section 172 and part VIII
16 of subchapter B).

17 “(3) PASSIVE INVESTMENT INCOME DE-
18 FINED.—

19 “(A) IN GENERAL.—Except as otherwise
20 provided in this paragraph, the term ‘passive
21 investment income’ means gross receipts de-
22 rived from royalties, rents, dividends, interest,
23 and annuities.

24 “(B) EXCEPTION FOR INTEREST ON
25 NOTES FROM SALES OF INVENTORY.—The term

1 ‘passive investment income’ shall not include in-
2 terest on any obligation acquired in the ordi-
3 nary course of the corporation’s trade or busi-
4 ness from its sale of property described in sec-
5 tion 1221(a)(1).

6 “(C) TREATMENT OF CERTAIN LENDING
7 OR FINANCE COMPANIES.—If the passthrough
8 corporation meets the requirements of section
9 542(c)(6) for the taxable year, the term ‘passive
10 investment income’ shall not include gross re-
11 cepts for the taxable year which are derived di-
12 rectly from the active and regular conduct of a
13 lending or finance business (as defined in sec-
14 tion 542(d)(1)).

15 “(D) TREATMENT OF CERTAIN DIVI-
16 DENDS.—If a passthrough corporation holds
17 stock in a C corporation meeting the require-
18 ments of section 1504(a)(2), the term ‘passive
19 investment income’ shall not include dividends
20 from such C corporation to the extent such divi-
21 dends are attributable to the earnings and prof-
22 its of such C corporation derived from the ac-
23 tive conduct of a trade or business.

24 “(E) EXCEPTION FOR BANKS, ETC.—In
25 the case of a bank (as defined in section 581)

1 or a depository institution holding company (as
2 defined in section 3(w)(1) of the Federal De-
3 posit Insurance Act (12 U.S.C. 1813(w)(1)),
4 the term ‘passive investment income’ shall not
5 include—

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

8 “(ii) dividends on assets required to
9 be held by such bank or company, includ-
10 ing stock in the Federal Reserve Bank, the
11 Federal Home Loan Bank, or the Federal
12 Agricultural Mortgage Bank or participa-
13 tion certificates issued by a Federal Inter-
14 mediate Credit Bank.

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

18 “(i) CAPITAL ASSETS OTHER THAN
19 STOCK AND SECURITIES.—In the case of
20 dispositions of capital assets (other than
21 stock and securities), gross receipts from
22 such dispositions shall be taken into ac-
23 count only to the extent of capital gain net
24 income therefrom.

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

6 “(G) COORDINATION WITH SECTION 773.—
7 The amount of passive investment income shall
8 be determined by not taking into account any
9 recognized built-in gain or loss of the pass-
10 through corporation for any taxable year in the
11 recognition period. Terms used in the preceding
12 sentence shall have the same respective mean-
13 ings as when used in section 773.

14 “(c) CREDITS NOT ALLOWABLE.—No credit shall be
15 allowed under part IV of subchapter A of this chapter
16 (other than section 34) against the tax imposed by sub-
17 section (a).

18 “(d) WAIVER OF TAX IN CERTAIN CASES.—If the
19 passthrough corporation establishes to the satisfaction of
20 the Secretary that—

21 “(1) it determined in good faith that it had no
22 accumulated earnings and profits at the close of a
23 taxable year, and

24 “(2) during a reasonable period of time after it
25 was determined that it did have accumulated earn-

1 ings and profits at the close of such taxable year
2 such earnings and profits were distributed,
3 the Secretary may waive the tax imposed by subsection
4 (a) for such taxable year.

5 **“SEC. 775. RECAPTURE OF LIFO BENEFITS.**

6 “(a) IN GENERAL.—If—

7 “(1) a passthrough corporation was a C cor-
8 poration for the last taxable year before the first
9 taxable year for which the election under section
10 703(a) was effective, and

11 “(2) the corporation inventoried goods under
12 the LIFO method for such last taxable year,
13 the LIFO recapture amount shall be included in the gross
14 income of the corporation for such last taxable year (and
15 appropriate adjustments to the basis of inventory shall be
16 made to take into account the amount included in gross
17 income under this subsection).

18 “(b) ADDITIONAL TAX PAYABLE IN INSTALL-
19 MENTS.—

20 “(1) IN GENERAL.—Any increase in the tax im-
21 posed by this chapter by reason of this section shall
22 be payable in 4 equal installments.

23 “(2) DATE FOR PAYMENT OF INSTALLMENTS.—
24 The first installment under paragraph (1) shall be
25 paid on or before the due date (determined without

1 regard to extensions) for the return of the tax im-
2 posed by this chapter for the last taxable year for
3 which the corporation was a C corporation and the
4 3 succeeding installments shall be paid on or before
5 the due date (as so determined) for the corporation's
6 return for the 3 succeeding taxable years.

7 “(3) NO INTEREST FOR PERIOD OF EXTEN-
8 SION.—Notwithstanding section 6601(b), for pur-
9 poses of section 6601, the date prescribed for the
10 payment of each installment under this subsection
11 shall be determined under this subsection.

12 “(c) LIFO RECAPTURE AMOUNT.—For purposes of
13 this section, the term ‘LIFO recapture amount’ means the
14 amount (if any) by which—

15 “(1) the inventory amount of the inventory
16 asset under the first-in, first-out method authorized
17 by section 471, exceeds

18 “(2) the inventory amount of such assets under
19 the LIFO method.

20 For purposes of the preceding sentence, inventory
21 amounts shall be determined as of the close of the last
22 taxable year referred to in subsection (a).

23 “(d) OTHER DEFINITIONS.—For purposes of this
24 section—

1 “(1) LIFO METHOD.—The term ‘LIFO meth-
2 od’ means the method authorized by section 472.

3 “(2) INVENTORY ASSETS.—The term ‘inventory
4 assets’ means stock in trade of the corporation, or
5 other property of a kind which would properly be in-
6 cluded in the inventory of the corporation if on hand
7 at the close of the taxable year.

8 “(3) METHOD OF DETERMINING INVENTORY
9 AMOUNT.—The inventory amount of assets under a
10 method authorized by section 471 shall be deter-
11 mined—

12 “(A) if the corporation uses the retail
13 method of valuing inventories under section
14 472, by using such method, or

15 “(B) if subparagraph (A) does not apply,
16 by using cost or market, whichever is lower.

17 “(4) NOT TREATED AS MEMBER OF AFFILI-
18 ATED GROUP.—Except as provided in regulations,
19 the corporation referred to in subsection (a) shall
20 not be treated as a member of an affiliated group
21 with respect to the amount included in gross income
22 under subsection (a).

23 “(e) SPECIAL RULE.—Sections 713(2)(B)(ii) and
24 771(e)(1) shall not apply with respect to any increase in
25 the tax imposed by reason of this section.

1 **“SEC. 776. APPLICATION OF PASSTHROUGH CORPORATION**
2 **RULES TO PRE-EXISTING S CORPORATIONS.**

3 “In the case of a corporation treated as having made
4 the election under section 703(a) by reason of section
5 703(d)—

6 “(1) such election shall not be taken into ac-
7 count in determining the 1st taxable year for which
8 the corporation was a passthrough corporation,

9 “(2) such corporation shall be treated for pur-
10 poses of this chapter as a passthrough corporation
11 for any taxable year for which such corporation had
12 an election in effect under section 1362 (as in effect
13 before its repeal), and

14 “(3) any election under such section 1362 shall
15 be treated for purposes of this chapter as an election
16 under section 703(a).”

17 (d) WITHHOLDING.—

18 (1) IN GENERAL.—Chapter 24 is amended by
19 adding at the end the following new subchapter:

20 **“Subchapter B—Withholding on Distributive**
21 **Share of Passthrough Income**

22 **“SEC. 3411. WITHHOLDING OF TAX ON OWNER’S DISTRIBU-**
23 **TIVE SHARE OF PASSTHROUGH INCOME.**

24 “(a) IN GENERAL.—A passthrough shall pay (at such
25 time and in such manner as the Secretary may provide),

1 with respect to each owner, a withholding tax under this
2 section equal to **[x]** percent of the excess (if any) of—

3 “(1) such owner’s distributive share of items of
4 income and gain, over

5 “(2) such owner’s distributive share of items of
6 deduction and loss.

7 “(b) SEPARATE APPLICATION IN CASES OF DIF-
8 FERENT DISTRIBUTIVE SHARES.—In the case of an owner
9 which has a different distributive share with respect to
10 capital gain rate items than with respect to ordinary
11 items, this section shall be applied separately with respect
12 to capital gain rate items and ordinary items.

13 “(c) PAYMENT OF WITHHOLDING TAX TREATED AS
14 DISTRIBUTION TO OWNER.—Except as provided in regu-
15 lations, any withholding tax paid by a passthrough under
16 subsection (a) with respect to any owner shall be treated
17 as distributed to such owner by such passthrough on the
18 earlier of—

19 “(1) the day on which such tax was paid by the
20 passthrough, or

21 “(2) the last day of the passthrough’s taxable
22 year for which such tax was paid.

23 “(d) WITHHOLDING TAX COLLECTED IN SAME MAN-
24 NER AS ESTIMATED TAXES.—Except as otherwise pro-
25 vided by the Secretary, for purposes of section 6655—

1 ENDS.—Such credit shall be allowed for the owner’s tax-
2 able year in which (or with which) the passthrough taxable
3 year (with respect to which the distributive share of the
4 owner was determined) ends.”.

5 (e) CONFORMING AMENDMENTS.—【to be provided】

6 (f) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years of passthroughs
8 (as defined in section 702 of the Internal Revenue Code
9 of 1986, as amended by this section) beginning after De-
10 cember 31, 2013.

11 **Subtitle D—Other Business Tax**

12 **Reforms**

13 **SEC. 2** ____ . 【TO BE PROVIDED】.

14 **TITLE III—PARTICIPATION EX-**

15 **EMPTION SYSTEM FOR THE**

16 **TAXATION OF FOREIGN IN-**

17 **COME**

18 **SEC. 301.** 【TO BE PROVIDED】.

19 **TITLE IV—OTHER REFORMS**

20 **SEC. 401.** 【TO BE PROVIDED】.