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
to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) Table of Contents.—The table of contents of 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. 241. [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].
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.

(a) IN GENERAL.—

(1) DOLLAR LIMITATION.—Paragraph (1) of section 179(b) is amended by striking “shall not exceed—” and all that follows and inserting “shall not exceed $250,000.”.

(2) REDUCTION IN LIMITATION.—Paragraph (2) of section 179(b) is amended by striking “exceeds—” and all that follows and inserting “exceeds $800,000.”.

(b) COMPUTER SOFTWARE.—Clause (ii) of section 179(d)(1)(A) is amended by striking “and before 2014”. 
(c) **Election.**—Paragraph (2) of section 179(c) is amended by striking “may not be revoked” and all that follows through “and before 2014”.

(d) **Qualified Real Property.**—Section 179(f) is amended—

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

(2) by striking paragraph (4).

(e) **Inflation Adjustment.**—Subsection (b) of section 179 is amended by adding at the end the following new paragraph:

“(6) **Inflation Adjustment.**—

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

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘2013’ for ‘1992’ in subparagraph (B) thereof.

“(B) Rounding.—The amount of any increase under subparagraph (A) shall be rounded to the nearest multiple of $10,000.”.
(f) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2013.

SEC. 212. LIMITATION ON USE OF CASH METHOD OF ACCOUNTING.

(a) In General.—Section 448 is amended to read as follows:

“SEC. 448. LIMITATION ON USE OF CASH METHOD OF ACCOUNTING.

“(a) In General.—The cash receipts and disbursements method of accounting may only be used by—

“(1) a natural person, and

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

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

“(b) Gross Receipts Test.—For purposes of this section—

“(1) In General.—A taxpayer meets the gross receipts test of this subsection for any taxable year if the average annual gross receipts of such taxpayer for the 3-taxable-year period ending with the taxable year which precedes such taxable year does not exceed $10,000,000.
“(2) Aggregation rules.—All persons treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414 shall be treated as one person for purposes of paragraph (1).

“(3) Special rules.—For purposes of this subsection—

“(A) Not in existence for entire 3-year period.—If the taxpayer was not in existence for the entire 3-year period referred to in paragraph (1), such paragraph shall be applied on the basis of the period during which such taxpayer (or trade or business) was in existence.

“(B) Short taxable years.—Gross receipts for any taxable year of less than 12 months shall be annualized by multiplying the gross receipts for the short period by 12 and dividing the result by the number of months in the short period.

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

“(D) Treatment of predecessors.—Any reference in this subsection to a taxpayer
shall include a reference to any predecessor of such taxpayer.

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

“(d) SPECIAL RULES.—For purposes of this section—

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

“(A) such change shall be treated as initiated by the taxpayer, and

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

“(2) USE OF RELATED PARTIES, ETC.—The Secretary shall prescribe such regulations as may be
necessary to prevent the use of related parties, pass-
thru entities, or intermediaries to avoid the applica-
tion of this section.”.

(b) CONFORMING AMENDMENTS.—

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

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

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

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

“(2) EXCEPTION.—Paragraph (1) shall not
apply to any amount if interest is required to be
paid on such amount or there is any penalty for failure to timely pay such amount.

“(3) REGULATIONS.—The Secretary shall prescribe regulations to permit taxpayers to determine amounts referred to in paragraph (1) using computations or formulas which, based on experience, accurately reflect the amount of income that will not be collected by such person. A taxpayer may adopt, or request consent of the Secretary to change to, a computation or formula that clearly reflects the taxpayer’s experience. A request under the preceding sentence shall be approved if such computation or formula clearly reflects the taxpayer’s experience.”.

(c) EFFECTIVE DATE.—

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

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

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

(B) which was prohibited under section 481 of the Internal Revenue Code of 1986 prior
to such amendments and is permitted under such section after such amendments, such change shall be treated as initiated by the taxpayer and made with the consent of the Secretary of the Treasury.

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

(a) IN GENERAL.—Part II of subchapter E of chapter 1 is amended by striking section 447 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Section 4972(c)(6) is amended in by striking “section 447(e)(1)” and inserting “section 354(a)(2)(D)(iii)(I)”.

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

“(C) NONQUALIFIED PREFERRED STOCK.—Nonqualified preferred stock (as defined in section 351(g)(2)) received in exchange for stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.
“(D) Recapitalizations of family-owned corporations.—

“(i) In general.—Subparagraph (C) shall not apply in the case of a recapitalization under section 368(a)(1)(E) of a family-owned corporation.

“(i) Family-owned corporation.—For purposes of this subparagraph, except as provided in regulations, the term ‘family-owned corporation’ means any corporation which is described in clause (ii) throughout the 8-year period beginning on the date which is 5 years before the date of the recapitalization. For purposes of the preceding sentence, stock shall not be treated as owned by a family member during any period described in section 355(d)(6)(B).

“(ii) Corporation described.—A corporation is described in this clause if at least 50 percent of the total combined voting power of all classes of stock entitled to vote, and at least 50 percent of all other classes of stock of the corporation, are owned by members of the same family.
“(iii) Members of the same family.—For purposes of this subpara-
graph—

“(I) the members of the same family are an individual, such individ-
ual’s brothers and sisters, the broth-
ers and sisters of such individual’s parents and grandparents, the ances-
tors and lineal descendants of any of the foregoing, a spouse of any of the foregoing, and the estate of any of the foregoing,

“(II) stock owned, directly or in-
directly, by or for a partnership or trust shall be treated as owned propor-
tionately by its partners or beneficiaries, and

“(III) if 50 percent or more in value of the stock in a corporation (hereinafter in this paragraph referred to as ‘first corporation’) is owned, di-
rectly or through subclause (II), by or for members of the same family, such members shall be considered as own-
ing each class of stock in a second
corporation (or a wholly owned subsidiary of such second corporation) owned, directly or indirectly, by or for the first corporation, in that proportion which the value of the stock in the first corporation which such members so own bears to the value of all the stock in the first corporation.

For purposes of subclause (I), individuals related by the half blood or by legal adoption shall be treated as if they were related by the whole blood.”.

(c) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 2013.

(2) Change in method of accounting.—In the case of any taxpayer required by the amendments made by this section to change its method of accounting for its first taxable year beginning after December 31, 2013—

(A) such change shall be treated as initiated by the taxpayer, and
such change shall be treated as made with the consent of the Secretary of the Treasury.

SEC. 214. MODIFICATION OF RULES FOR CAPITALIZATION AND INCLUSION IN INVENTORY COSTS OF CERTAIN EXPENSES.

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

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

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

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

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

“(4) FILMS, SOUND RECORDINGS, BOOKS, etc.—For purposes of this subsection, the term ‘tangible personal property’ shall include a film, sound recording, video tape, book, or similar property.”

(b) EFFECTIVE DATE.—

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

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

(A) such change shall be treated as initiated by the taxpayer, and

(B) such change shall be treated as made with the consent of the Secretary of the Treasury.
SEC. 215. UNIFICATION OF DEDUCTION FOR START-UP AND ORGANIZATIONAL EXPENDITURES.

(a) In General.—Subsection (a) of section 195 is amended by inserting “and organizational” after “start-up”.

(b) Organizational Expenditures.—Subsection (c) of section 195 is amended by adding at the end the following new paragraph:

“(3) Organizational Expenditures.—The term ‘organizational expenditures’ means any expenditure which—

“(A) is incident to the creation of a corporation or a partnership,

“(B) is chargeable to capital account, and

“(C) is of a character which, if expended incident to the creation of a corporation or a partnership having a limited life, would be amortizable over such life.”.

(c) Dollar Amounts.—Clause (ii) of section 195(b)(1)(A) is amended—

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

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

(d) Conforming Amendments.—

(1) Section 195(b)(1) is amended—
(A) by inserting “(or, in the case of a partnership, the partnership elects)” after “If a taxpayer elects”,

(B) by inserting “(or the partnership, as the case may be)” after “the taxpayer” in subparagraph (A),

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

(2) Section 195(b)(2) is amended—

(A) by striking “AMORTIZATION PERIOD.—
In any case” and inserting the following: “AMORTIZATION PERIOD.—

“(A) IN GENERAL.—In any case”, and

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

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

(3) Section 195(b) is amended by striking paragraph (3).

(4)(A) Part VIII of subchapter B of chapter 1 is amended by striking section 248 (and by striking the item relating to such section in the table of sections for such part).
(B) Section 170(b)(2)(C)(ii) is amended by striking “(except section 248)”.

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

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

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

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

(G) Section 852(b)(2)(C) is amended by striking “(except section 248)”.

(H) Section 857(b)(2)(A) is amended by striking “(except section 248)”.

(I) Section 1363(b) is amended by inserting “and” at the end of paragraph (2), by striking paragraph (3), and by redesignating paragraph (4) as paragraph (3).

(J) Section 1375(b)(1)(B)(i) is amended by striking “(other than the deduction allowed by section 248, relating to organization expenditures)”.

(5) Part I of subchapter K of chapter 1 is amended by striking section 709 (and by striking
the item relating to such section in the table of sections for such part).

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

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.

(a) PARTNERSHIPS.—

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

“(f) RETURNS OF PARTNERSHIPS.—Returns of partnerships under section 6031 made on the basis of the calendar year shall be filed on or before the 15th day of March following the close of the calendar year, and such returns made on the basis of a fiscal year shall be filed on or before the 15th day of the third month following the close of the fiscal year.”.

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

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

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

(2) CONFORMING AMENDMENTS.—

(A) Section 1362(b) is amended—

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

(ii) by striking “2 1⁄2” each place it appears and inserting “3”, and

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

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

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

March 11, 2013 (12:49 p.m.)
(c) Conforming Amendments Relating to Corporations.—

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

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

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

(4) Subsection (a) and (c) of section 6167 are each amended by striking “third month” and inserting “4th month”.

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

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

(d) Effective Date.—The amendments made by this section shall apply to returns for taxable years beginning after December 31, 2013.

SEC. 222. MODIFICATION OF DUE DATES BY REGULATION.

In the case of returns for taxable years beginning after December 31, 2013, the Secretary of the Treasury or the Secretary’s delegate shall modify appropriate regulations to provide as follows:
(1) The maximum extension for the returns of partnerships filing Form 1065 shall be a 6-month period ending on September 15 for calendar year taxpayers.

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

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

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

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

(6) The due date of Form TD F 90–22.1 (relating to Report of Foreign Bank and Financial Accounts) shall be April 15 with a maximum extension for a 6-month period ending on October 15 and with provision for an extension under rules similar to the
rules in Treas. Reg. section 1.6081–5. For any taxpayer required to file such Form for the first time, any penalty for failure to timely request for, or file, an extension, may be waived by the Secretary.

SEC. 223. CORPORATIONS PERMITTED STATUTORY AUTOMATIC 6-MONTH EXTENSION OF INCOME TAX RETURNS.

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

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

Subtitle C—[Option 1] Passthrough Entities

PART 1—[OPTION 1] S CORPORATIONS

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

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

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

(2) by redesignating subparagraph (E) as subparagraph (B), and

(3) by inserting before subparagraph (B) (as so redesignated) the following new subparagraph:
“(A) IN GENERAL.—The term ‘recognition period’ means the 5-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation. For purposes of applying this section to any amount includible in income by reason of distributions to shareholders pursuant to section 593(e), the preceding sentence shall be applied without regard to the phrase ‘5-year’."

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

SEC. 232. MODIFICATIONS TO S CORPORATION PASSIVE INVESTMENT INCOME RULES.

(a) INCREASED PERCENTAGE LIMIT.—Paragraph (2) of section 1375(a) is amended by striking “25 percent” and inserting “60 percent”.

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

(c) CONFORMING AMENDMENTS.—

(1) Subsection (b) of section 1375 is amended by striking paragraphs (3) and (4) and inserting the following new paragraph:
“(3) Passive investment income defined.—

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

“(B) Exception for interest on notes from sales of inventory.—The term ‘passive investment income’ shall not include interest on any obligation acquired in the ordinary course of the corporation’s trade or business from its sale of property described in section 1221(a)(1).

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

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

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

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

“(ii) dividends on assets required to be held by such bank or company, including stock in the Federal Reserve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.
“(F) Gross receipts from the sales of certain assets.—For purposes of this paragraph—

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

“(ii) Stock and securities.—In the case of sales or exchanges of stock or securities, gross receipts shall be taken into account only to the extent of the gain therefrom.

“(G) Coordination with section 1374.—The amount of passive investment income shall be determined by not taking into account any recognized built-in gain or loss of the S corporation for any taxable year in the recognition period. Terms used in the preceding sentence shall have the same respective meanings as when used in section 1374.”.
(2)(A) Subparagraph (J) of section 26(b)(2) is amended by striking “25 percent” and inserting “60 percent”.

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

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

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

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

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

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

(a) NO LOOK-THROUGH FOR ELIGIBILITY PURPOSES.—Subparagraph (C) of section 1361(b)(1) is amended by inserting “(determined without regard to subsection (e)(2)(B)(v))” after “shareholder”.
(b) **Effective Date.**—The amendment made by this section shall take effect on January 1, 2014.

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

(a) **In General.**—Paragraph (2) of section 641(c) is amended by moving subparagraph (D) after subparagraph (C) and by inserting after subparagraph (D) (as so moved) the following new subparagraph:

```
“(E)(i) Section 642(c) shall not apply.
“(ii) For purposes of section 170(b)(1)(G), adjusted gross income shall be computed in the same manner as in the case of an individual, except that the deductions for costs which are paid or incurred in connection with the administration of the trust and which would not have been incurred if the property were not held in such trust shall be treated as allowable in arriving at adjusted gross income.”.
```

(b) **Effective Date.**—The amendment made by this section shall apply to taxable years beginning after December 31, 2013.
SEC. 235. PERMANENT RULE REGARDING BASIS ADJUSTMENT TO STOCK OF S CORPORATIONS MAKING CHARITABLE CONTRIBUTIONS OF PROPERTY.

(a) In General.—Section 1367(a)(2) (relating to decreases in basis) is amended by striking the last sentence.

(b) Effective Date.—The amendment made by this section shall apply to contributions made in taxable years beginning after December 31, 2013.

SEC. 236. EXTENSION OF TIME FOR MAKING S CORPORATION ELECTIONS.

(a) In General.—Subsection (b) of section 1362 is amended to read as follows:

“(b) When Made.—

“(1) In General.—An election under subsection (a) may be made by a small business corporation for any taxable year not later than the due date for filing the return of tax for such taxable year (including extensions).

“(2) Certain elections treated as made for next taxable year.—

“(A) Certain late elections.—If an election is made for any taxable year after the period described in paragraph (1), then such election shall be treated as made for the fol-
lowing taxable year if made during the period described in paragraph (1) with respect to such following taxable year.

“(B) Certain timely elections.—If—

“(i) an election under subsection (a) is made for any taxable year within the period described in paragraph (1), but

“(ii) either—

“(I) on 1 or more days in such taxable year and before the day on which the election was made the corporation did not meet the requirements of subsection (b) of section 1361, or

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

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

“(3) Authority to treat late elections, etc., as timely.—If—

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

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

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

“(4) Election on timely filed returns.—Except as otherwise provided by the Secretary, an election under subsection (a) for any taxable year may be made on a timely filed return of tax of the small business corporation for such taxable year.

“(5) Secretarial authority.—The Secretary may prescribe such regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying this subsection.”.

(b) Revocations.—Paragraph (1) of section 1362(d) is amended—

(1) by striking “subparagraph (D)” in subparagraph (C) and inserting “subparagraphs (D) and (E)”, and

(2) by adding at the end the following new subparagraph:
“(E) Authority to treat late revocations as timely.—If—

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

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

(e) Effective Date.—

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

(2) Subsection (b).—The amendments made by subsection (b) shall apply to revocations after December 31, 2013.

SEC. 237. RELOCATION OF C CORPORATION DEFINITION.

(a) In General.—Subsection (a) of section 1361 is amended—

(1) by striking paragraph (2), and
(2) by striking “S CORPORATION DEFINED.—”

and all that follows through “For purposes of this

title, the term ‘S corporation’ means” and inserting

the following: “IN GENERAL.—For purposes of this

title, the term ‘S corporation’ means”.

(b) CONFORMING AMENDMENT.—Section 7701(a)(3)

is amended—

(1) by striking “CORPORATION.—The term

‘corporation’ means” and inserting the following:

“CORPORATIONS.—

“(1) IN GENERAL.—The term ‘corporation’

means”, and

(2) by adding at the end the following new

paragraph:

“(2) C CORPORATIONS.—The term ‘C corpora-

tion’ means, with respect to any taxable year, a cor-

poration which is not an S corporation for such

year.”.

(c) EFFECTIVE DATE.—The amendments made by

this section shall take effect on the date of the enactment

of this Act.
PART 2—[OPTION 1] PARTNERSHIPS

SEC. 241. REPEAL OF RULES RELATING TO GUARANTEED PAYMENTS AND LIQUIDATING DISTRIBUTIONS.

(a) Payment to Partner for Services or Use of Capital.—Section 707 is amended by striking subsection (c).

(b) Payments Made in Liquidation of Retiring or Deceased Partner.—Subpart B of part II of subchapter K of chapter 1 is amended by striking section 736 (and by striking the item relating to such section in the table of sections for such subpart).

(c) Conforming Amendments.—

(1) Section 267(e) is amended by striking paragraph (4).

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

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

(4) Section 731(d) is amended—

(A) by striking “section 736 (relating to payments to a retiring partner or a deceased partner’s successor in interest),”, and
(B) by striking “items), and” and inserting “items) and”.

(5) Section 751(b)(2) is amended—

(A) by striking subparagraph (B), and

(B) by striking “shall not apply to—” and all that follows through “a distribution of property” and inserting the following: “shall not apply to a distribution of property”.

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

(B) Section 691 is amended by striking subsection (e).

(7) Section 1402(a)(13) is amended by striking “other than guaranteed payments described in section 707(c)” and inserting “other than payments described in section 707(a)”.

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

(A) by striking “(after such gross income has been reduced by the sum of all payments to which section 707(c) applies)” in clauses (iii) and (iv), and
(B) by striking “(after such gross income has been so reduced)” in clause (iv).

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

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

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

SEC. 242. MANDATORY ADJUSTMENTS TO BASIS OF PARTNERSHIP PROPERTY IN CASE OF TRANSFER OF PARTNERSHIP INTERESTS.

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

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

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

(3) by adding at the end the following new subsection:

“(b) ALLOCATION OF BASIS.—
“(1) GENERAL RULE.—Any increase or decrease in the adjusted basis of partnership property under subsection (a) shall, except as provided in paragraph (2), be allocated—

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

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

“(2) SPECIAL RULE.—In applying the allocation rules provided in paragraph (1), increases or decreases in the adjusted basis of partnership property arising from a distribution of, or a transfer of an interest attributable to, property consisting of—

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

“(B) any other property of the partnership,

shall be allocated to partnership property of a like character except that the basis of any such partnership property shall not be reduced below zero.”.

(b) CONFORMING AMENDMENTS.—
(1) Section 732 is amended by striking subsection (d) and by redesignating subsections (e) and (f) as subsections (d) and (e), respectively.

(2) Section 761(c)(2) is amended by striking “optional”.

(3) Section 774(a) is amended by striking “section 743(b)” both places it appears and inserting “section 743(a)”.

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

(5) The heading for subsection (a) (as redesignated by this Act) of section 743 is amended by striking “ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY” and inserting “IN GENERAL”.

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

SEC. 243. MANDATORY ADJUSTMENTS TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY.

(a) IN GENERAL.—Section 734 is amended to read as follows:
“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY.

“(a) IN GENERAL.—In the case of any distribution to a partner, the partnership shall adjust the basis of partnership property such that each remaining partner’s net liquidation amount immediately after such distribution is equal to such partner’s net liquidation amount immediately before such distribution.

“(b) DISTRIBUTIONS OTHER THAN IN LIQUIDATION OF A PARTNER’S INTEREST.—In the case of any distribution to a partner other than in liquidation of such partner’s interest, proper adjustment shall be made under subsection (a) with respect to such partner to take into account—

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

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

“(c) NET LIQUIDATION AMOUNT.—For purposes of this section, the term ‘net liquidation amount’ means, with respect to any partner, the net amount of gain or loss (if any) which would be taken into account by the partner under section 702 if the partnership sold all of its assets
at fair market value (and no other amounts were taken into account under such section).

“(d) Allocation of Basis.—

“(1) Decreases in Basis.—Any decrease in the adjusted basis of partnership property which is required under this section—

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

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

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

“(2) Increases in Basis.—Any increase in the adjusted basis of partnership property which is required under this section—

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

“(B) shall be made only with respect to property other than unrealized receivables (as
defined in section 751(c)) and inventory (as defined in section 751(d)).

If any such increase is prevented by the absence of property described in subparagraph (B), each partner shall recognize a loss in the amount of such partner’s distributive share of such prevented increase. Such loss shall be treated as a loss from the sale of the partner’s partnership interest.

“(e) No Allocation of Basis Decrease to Stock of Corporate Partner.—In making an allocation under subsection (d) of any decrease in the adjusted basis of partnership property required under subsection (a)—

“(1) no allocation may be made to stock in a corporation (or any person related (within the meaning of section 267(b) or 707(b)(1)) to such corporation) which is a partner in the partnership, and

“(2) any amount not allocable to stock by reason of paragraph (1) shall be allocated under subsection (d) to other partnership property.

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

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

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

(2) Subsection (d) of section 1060 is amended—

(A) by striking “section 755” in paragraph (1) and inserting “sections 734 and 743”, and

(B) by striking “section 755” in paragraph (2) and inserting “section 734 or 743”.

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

SEC. 244. CORRESPONDING ADJUSTMENTS TO BASIS OF PROPERTIES HELD BY PARTNERSHIP WHERE PARTNERSHIP BASIS ADJUSTED.

(a) IN GENERAL.—Subpart B of part II of subchapter K of chapter 1, as amended by this Act, is amended by inserting after section 735 the following new section:
“SEC. 736. CORRESPONDING ADJUSTMENT TO BASIS OF PROPERTIES HELD BY LOWER-TIER PARTNERSHIP IN CASE OF UPPER-TIER PARTNERSHIP BASIS ADJUSTMENTS.

“(a) Distributions by Upper-tier Partnership.—In the case of any distribution of property to a partner by an upper-tier partnership, if such distribution results in an adjustment in the upper-tier partnership’s adjusted basis in an interest in a lower-tier partnership under section 734, then such lower-tier partnership shall make a corresponding adjustment to the adjusted basis of its partnership property.

“(b) Distributions of Interests in Lower-tier Partnership.—In the case of any distribution of an interest in a lower-tier partnership by an upper-tier partnership—

“(1) if the adjusted basis of such interest in the hands of the upper-tier partnership (determined immediately before such distribution) exceeds the adjusted basis of such interest in the hands of the distributee partner (determined immediately after such distribution), then such lower-tier partnership shall decrease the adjusted basis of its partnership property by the amount of such excess, or

“(2) if the adjusted basis of such interest in the hands of the distributee partner (determined imme-
diately after such distribution) exceeds the adjusted basis of such interest in the hands of the upper-tier partnership (determined immediately before such distribution), then such lower-tier partnership shall increase the adjusted basis of its partnership property by the amount of such excess.

“(c) Dispositions of Interests in Upper-Tier Partnership.—In the case of a disposition of an interest in an upper-tier partnership which holds an interest in a lower-tier partnership, if there is an adjustment to the adjusted basis of the lower-tier partnership under section 743, then such lower-tier partnership shall make a corresponding adjustment to the adjusted basis of its partnership property.

“(d) Multi-Tiered Partnerships.—In the case of any adjustment under subsection (a), (b), or (c) in the adjusted basis of an interest in another partnership, such other partnership shall make a corresponding adjustment in the adjusted basis of its partnership property.

“(e) Allocation of Basis; Recognition of Gain.—In the case of any adjustment in the adjusted basis of partnership property—

“(1) under subsection (a), (b), (e), or (d), such adjustment shall be made only with respect to the upper-tier partnership’s proportionate share (as de-
termined under section 743(a)) of the adjusted basis
of the lower-tier partnership’s property,
“(2) under subsection (a) or (b) (or so much of
subsection (d) as relates to either such subsection),
rules similar to the rules of section 734(d) shall
apply, and
“(3) under subsection (c) (or so much of sub-
section (d) as relates to such subsection), rules simi-
lar to the rules of section 743(b) shall apply.
“(f) REPORTING.—In the case of any adjustment in
the adjusted basis of partnership property by a lower-tier
partnership under this section by reason of a distribution
by, or a disposition of an interest in, an upper-tier part-
nership, such upper-tier partnership shall furnish (in such
manner as the Secretary shall prescribe) to such lower-
tier partnership such information as is necessary to enable
such lower-tier partnership to make such adjustment.
“(g) UPPER- AND LOWER-TIER PARTNERSHIPS.—
For purposes of this section—
“(1) UPPER-TIER PARTNERSHIP.—The term
‘upper-tier partnership’ means a partnership owning
an interest in another partnership.
“(2) LOWER-TIER PARTNERSHIP.—The term
‘lower-tier partnership’ means the partnership re-
ferred to in paragraph (1) an interest in which is
owned by the upper-tier partnership.”.

(b) Effective Dates.—The amendments made by
this section shall apply to distributions and transfers after
December 31, 2013.

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

(a) In General.—Subsection (d) of section 704 is
amended—

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

“(1) In General.—A partner’s distributive
share”,

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

“(2) Carryover.—Any excess of such loss”,

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

“(3) Special Rules.—In determining the
amount of any loss under paragraph (1), there shall
be taken into account as a deduction the partner’s
distributive share of—
“(A) the adjusted basis of charitable contributions described in paragraph (4) of section 702(a), and

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

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years beginning after December 31, 2013.

SEC. 246. REVISIONS RELATED TO UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) REPEAL OF REQUIREMENT THAT INVENTORY BE SUBSTANTIALLY APPRECIATED IN CERTAIN PARTNERSHIP DISTRIBUTIONS TREATED AS SALE OR EXCHANGE.—

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

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

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

(b) REVISION OF REGULATIONS RELATING TO TREATMENT OF UNREALIZED RECEIVABLES AND INVENTORY ITEMS.—The Secretary of the Treasury shall revise
regulations issued under section 751(b) of the Internal
Revenue Code of 1986 to take into account the partner’s
share of income and gain rather than the partner’s share
of partnership assets.

(c) Simplification of Definition of Unrealized Receivables.—

(1) In general.—Section 751(c) is amended by striking all that follows paragraph (2) and insert-
ing the following:

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

(2) Effective date.—The amendment made by this subsection shall apply to partnership taxable years beginning after December 31, 2013.

SEC. 247. REPEAL OF TIME LIMITATION ON TAXING PRECONTRIBUTION GAIN.

(a) In general.—Subparagraph (B) of section 704(e)(1) is amended by striking “within 7 years of being contributed”.
(b) CONFORMING AMENDMENT.—Paragraph (1) of section 737(b) is amended by striking “within 7 years of the distribution”.

c) EFFECTIVE DATE.—The amendments made by this section shall apply to property contributed to a partnership after December 31, 2013.

Subtitle C—[Option 2] Unified Rules for Passthroughs

SEC. 231. UNIFIED RULES FOR PASSTHROUGHS.

(a) REPEAL OF PARTNERSHIP RULES.—Chapter 1 is amended by striking subchapter K (and by striking the item relating to such subchapter in the table of subchapters for such chapter).

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

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

“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
PART I—GENERAL PROVISIONS

Sec. 701. Tax treatment of passthrough.
Sec. 702. Passthrough defined.
Sec. 703. Passthrough corporation.
Sec. 704. Computation of passthrough items.

SEC. 701. TAX TREATMENT OF PASSTHROUGH.

(a) In General.—Except as otherwise provided in this subchapter, a passthrough shall not be subject to the taxes imposed by this chapter.

(b) Withholding.—For withholding on owner’s distributive share of passthrough income, see subchapter B of chapter 24.

SEC. 702. PASSTHROUGH DEFINED.

(a) In General.—For purposes of this subchapter, the term ‘passthrough’ means—

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

(2) any passthrough corporation.

(b) Exception for Certain Unincorporated Organizations.—Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if—

(1) it is availed of—

(A) for investment purposes only and not for the active conduct of a business,
“(B) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or

“(C) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities, and

“(2) the income of the members of the organization may be adequately determined without the computation of passthrough items.

“(c) CERTAIN JOINT VENTURES OF SPOUSES.—

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

“(A) such joint venture shall not be treated as a passthrough,

“(B) all items of income, gain, loss, deduction, and credit shall be divided between the spouses in accordance with their respective interests in the venture, and

“(C) each spouse shall take into account such spouse’s respective share of such items as if they were attributable to a trade or business conducted by such spouse as a sole proprietor.
“(2) QUALIFIED JOINT VENTURE.—For purposes of this subsection, the term ‘qualified joint venture’ means any joint venture involving the conduct of a trade or business if—

“(A) the only members of such joint venture are a husband and wife,

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

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

“SEC. 703. PASSTHROUGH CORPORATION.

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

“(b) EXCEPTIONS.—

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

“(A) publicly traded,
“(B) a financial institution which uses the reserve method of accounting for bad debts described in section 585,
“(C) an insurance company subject to tax under subchapter L, or
“(D) a DISC or former DISC.
“(2) PUBLICLY TRADED.—For purposes of this subsection, a corporation shall be treated as publicly traded if—
“(A) shares of such corporation are traded on any established securities market (within the meaning of section 1273(b) or 7704(b)), or
“(B) shares of such corporation are readily tradable on a secondary market (or the substantial equivalent thereof).
“(c) ELECTION.—
“(1) IN GENERAL.—Except as otherwise provided in this subsection, an election under subsection (a) for any taxable year shall be made not later than the due date for filing the return of tax for such taxable year (including extensions).
“(2) CERTAIN LATE ELECTIONS TREATED AS MADE FOR NEXT TAXABLE YEAR.—If an election is made for any taxable year after the period described in paragraph (1), then such election shall be treated
as made for the following taxable year if made during the period described in paragraph (1) with respect to such following taxable year.

“(3) Authority to treat late elections, etc., as timely.—If—

“(A) an election under subsection (a) is made for any taxable year after the date prescribed by this subsection for making such election for such taxable year or no such election is made for any taxable year, and

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

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

“(4) Election on timely filed returns.—

Except as otherwise provided by the Secretary, an election under subsection (a) for any taxable year may be made on a timely filed return of tax of the passthrough for such taxable year.

“(5) Secretarial authority.—The Secretary may prescribe such regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying this subsection.
“(d) Transition Rule for Pre-existing S Corporations.—

“(1) In general.—In the case of a corporation which was an S corporation (as defined in section 1361(a)(1) as in effect before its repeal) for such corporation’s last taxable year beginning before January 1, 2014, such corporation shall be treated as having made the election under subsection (a) for such corporation’s first taxable year beginning after December 31, 2013, unless such corporation elects (under rules similar to the rules of subsection (c)) to have this subsection not apply.

“(2) Cross Reference.—For application of part V to pre-existing S corporations, see section 776.

“Sec. 704. Computation of Passthrough Items.

“(a) In general.—The taxable income of the passthrough (and each of the passthrough items described in section 711) shall be computed in the same manner as in the case of an individual, except that—

“(1) the following deductions shall not be allowed to the passthrough:

“(A) the deductions for personal exemptions provided in section 151,
“(B) the deduction for taxes provided in section 164(a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

“(C) the deduction for charitable contributions provided in section 170,

“(D) the net operating loss deduction provided in section 172,

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

“(F) the deduction for depletion under section 611 with respect to oil and gas wells, and

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

“(b) ELECTIONS MADE BY PASSTROUGH.—

“(1) IN GENERAL.—Except as provided in paragraph (2), any election affecting the computation of passthrough items shall be made by the passthrough.

“(2) EXCEPTION.—In the case of a passthrough, elections under section 901 (relating to taxes of foreign countries and possessions of the
United States) shall be made by each owner separately.

“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.

“SEC. 711. PASSTHROUGH OF ITEMS TO OWNERS.

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

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

“(2) charitable contributions (as defined in section 170(c)) of the passthrough, and

“(3) taxes, described in section 901, paid or accrued (or deemed to have paid or accrued) by the passthrough to foreign countries and to possessions of the United States.

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

“(c) PROVISION OF INFORMATION.—To the extent provided by the Secretary in regulations or other guidance,
the passthrough shall provide such information with respect to the characteristics of any passthrough item as is necessary for the owner to determine his taxable income.

"SEC. 712. DETERMINATION OF OWNER'S DISTRIBUTIVE SHARE.

"(a) IN GENERAL.—An owner's distributive share shall, except as otherwise provided in this subchapter, be determined by the ownership agreement.

"(b) DISTRIBUTIVE SHARE MUST BE CONSISTENT WITH OWNER'S ECONOMIC INTEREST.—

"(1) IN GENERAL.—If any owner's distributive share under the ownership agreement is inconsistent with such owner's economic interest in the passthrough, the distributive share of such owner shall be adjusted (consistent with the requirements of subsection (e)) so as to be consistent with such owner's economic interest in the passthrough.

"(2) DISTRIBUTIVE SHARE NOT DETERMINED UNDER OWNERSHIP AGREEMENT.—If the ownership agreement does not provide as to an owner's distributive share, the distributive share of such owner shall be determined (consistent with the requirements of subsection (e)) in accordance with such owner's economic interest in the passthrough.
“(3) Corresponding Adjustments to Distributive Share of Other Owners.—If any owner’s distributive share is adjusted or determined under this subsection, the distributive shares of all other owners shall be properly adjusted consistent with the requirements of subsection (c) and with each owner’s economic interest in the passthrough.

“(4) Determination of Economic Interest.—For purposes of this subsection and section 743(a), an owner’s economic interest in a passthrough shall be determined by taking into account all facts and circumstances.

“(c) Restriction on Different Distributive Shares of Items to Same Owner.—

“(1) Distributive share of items in same category must be the same.—Except as provided in subsection (d) and section 751(b), if an owner receives a distributive share of any passthrough item, such owner shall receive the same distributive share (when expressed as a percentage) of all other passthrough items which are in the same category.

“(2) Categories of passthrough items.—For purposes of this section—
“(A) IN GENERAL.—Each of the following clauses is a separate category of pass-through items:

“(i) Ordinary items.

“(ii) Capital gain rate items.

“(iii) Credits.

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

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

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

“(C) ORDINARY ITEMS.—The term ‘ordinary items’ means any pass-through item which is not a capital gain rate item, a credit, or a tax to which paragraph (3) applies.

“(3) FOREIGN TAXES.—Notwithstanding any other provision of this section, an owner’s distributive share of any tax described in section 711(a)(3) shall be the same as such owner’s distributive share of the pass-through items on which such tax was imposed.

“(4) REGULATIONS TO PREVENT AVOIDANCE.—The Secretary shall issue regulations or other guidance which prevent the avoidance of the purposes of
this subsection. Such regulations or other guidance shall include rules which provide for the application of this subsection with respect to passthroughs which are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414.

“(d) CONTRIBUTED PROPERTY.—

“(1) IN GENERAL.—Under regulations prescribed by the Secretary—

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

“(B) if any property so contributed is distributed (directly or indirectly) by the pass-through (other than to the contributing owner)—

“(i) the contributing owner shall be treated as recognizing loss from the sale of such property in an amount equal to the loss that would have been allocated to such owner under subparagraph (A) by reason
of the variation described in subparagraph
(A) if the property had been sold at its fair
market value at the time of distribution,

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

“(iii) appropriate adjustments shall be made to the adjusted basis of the contributing owner’s pass-through interest and to the adjusted basis of the property distributed to reflect any loss recognized under this subparagraph, and

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

“(i) such built-in loss shall be taken into account only in determining the amount of items allocated to the contributing owner, and

“(ii) except as provided in regulations, in determining the amount of items allocated to other owners, the basis of the contributed property in the hands of the pass-through shall be treated as being equal to
its fair market value at the time of contribution.

For purposes of subparagraph (B), the term ‘built-in loss’ means the excess of the adjusted basis of the property (determined without regard to subparagraph (C)(ii)) over its fair market value at the time of contribution.

“(2) OTHER RULES.—Under regulations prescribed by the Secretary, rules similar to the rules of paragraph (1) shall apply to contributions by an owner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items. Any reference in paragraph (1) to the contributing owner shall be treated as including a reference to any successor of such owner.

“(e) LIMITATION ON ALLOWANCE OF LOSSES.—

“(1) IN GENERAL.—An owner’s distributive share of passthrough loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such owner’s passthrough interest at the end of the passthrough year in which such loss occurred.

“(2) CARRYOVER.—Any excess of such loss over such basis shall be allowed as a deduction at the end
of the passthrough year in which such excess is repaid to the passthrough.

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

“(A) the adjusted basis of charitable contributions described in paragraph (2) of section 711(a), and

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

“(f) FAMILY PASSTHROUGHS.—

“(1) RECOGNITION OF PASSTHROUGH INTEREST CREATED BY PURCHASE OR GIFT.—An individual shall be recognized as an owner for purposes of this subtitle if—

“(A) he owns a capital interest in a passthrough in which capital is a material income-producing factor, and

“(B) such capital interest was derived by purchase or gift from a member of such individual’s family.

“(2) DISTRIBUTIVE SHARE OF DONEE INCLUDEABLE IN GROSS INCOME.—In the case of any passthrough interest created by gift, the distributive
share of the donee under the ownership agreement shall be properly adjusted under subsection (b)(1) to the extent that such share is determined without allowance of reasonable compensation for services rendered to the passthrough by the donor and to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor’s capital. The distributive share of an owner in the earnings of the passthrough shall not be diminished because of absence due to military service.

“(3) Purchase of passthrough interest by member of family.—For purposes of this section, a passthrough interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital.

“(4) Family.—For purposes of this subsection, the “family” of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.
“SEC. 713. DETERMINATION OF OWNER’S BASIS IN PASS-
THROUGH INTEREST.

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

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

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

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

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

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

“(A) the reductions provided under section 
733,

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

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

“(ii) expenditures of the passthrough 
not deductible in computing its taxable in-
come and not properly chargeable to capital account, and

“(C) the amount of the owner’s distributive share of the deduction for depletion for any oil and gas property of the passthrough to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such owner under section 613A(e)(7)(D).

“PART III—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

“SUBPART A—CONTRIBUTIONS

“SUBPART B—DISTRIBUTIONS

“SUBPART C—TRANSFERS

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

“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, inventory items, and capital loss property.

“SEC. 721. NONRECOGNITION OF GAIN OR LOSS ON CONTRIBUTION.

“(a) In General.—No gain or loss shall be recognized to a passthrough or to any of its owners in the case of a contribution of property to the passthrough in exchange for a passthrough interest.
(b) SPECIAL RULE.—Subsection (a) shall not apply to gain realized on a transfer of property to any pass-through which is treated as an investment company (within the meaning of section 351) or which would be so treated if such pass-through were incorporated.

(c) REGULATIONS RELATING TO CERTAIN TRANSFERS TO PASTHROUGHS.—The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a pass-through if such gain, when recognized, will be includible in the gross income of a person other than a United States person.

(d) TRANSFERS OF INTANGIBLES.—For treatment of intangibles transferred to a pass-through as sold, see section 367(d).

SEC. 722. BASIS WITH RESPECT TO CONTRIBUTED PROPERTY.

(a) BASIS OF CONTRIBUTING OWNER’S PASTHROUGH INTEREST.—The basis of a pass-through interest acquired by a contribution of property, including money, to the pass-through shall be the amount of such money and the adjusted basis of such property to the contributing owner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing owner at such time.
“(b) Basis of Property Contributed to Pass-through.—The basis of property contributed to a pass-through by an owner shall be the adjusted basis of such property to the contributing owner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing owner at such time.

“SEC. 723. CHARACTER OF GAIN OR LOSS ON CONTRIBUTED UNREALIZED RECEIVABLES, INVENTORY ITEMS, AND CAPITAL LOSS PROPERTY.

“(a) Contributions of Unrealized Receivables and Inventory Items.—In the case of any property that—

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

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

any gain or loss recognized by the passthrough on the disposition of such property shall be treated as ordinary income or ordinary loss, as the case may be.

“(b) Contributions of Capital Loss Property.—In the case of any property that—

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

“(e) DEFINITIONS.—For purposes of this section—

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

“(2) INVENTORY ITEM.—The term ‘inventory item’ has the meaning given such term by section 751(d) (determined by treating any reference to the passthrough as referring to the owner and by applying section 1231 without regard to any holding period therein provided).

“(3) SUBSTITUTED BASIS PROPERTY.—

“(A) IN GENERAL.—If any property described in subsection (a) or (b) is disposed of in a nonrecognition transaction, the tax treatment that applies to such property under such sub-
section shall also apply to any substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of nonrecognition transactions.

“(B) EXCEPTION FOR STOCK IN C CORPORATION.—Subparagraph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351.

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 adjustments.

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

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

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

“(2) AMOUNT IN EXCESS OF BASIS.—If the fair market value of property, and the amount of money, distributed exceeds the adjusted basis of the owner’s
passthrough interest, such excess shall be treated as
gain from the sale or exchange of such passthrough
interest.

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

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

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

Notwithstanding subparagraph (B), no loss shall be
recognized on the termination of an owner’s pas-
sthrough interest unless such termination constitutes
the termination of all direct and indirect interests of
the owner in the passthrough. Any loss not recog-
nized by reason of the preceding sentence shall be
recognized upon the termination of all such direct
and indirect interests.

“(b) PASSTHOUGHS.—

“(1) IN GENERAL.—Except as provided in para-
graph (2), no gain or loss shall be recognized to the
passthrough on a distribution to an owner of prop-
erty, including money.
“(2) Deemed sale of appreciated property.—In the case of a distribution of property other than money, for purposes of determining any gain recognized by the passthrough, such passthrough shall be treated as if it had sold such property for its fair market value immediately before the distribution of such property to the owner.

“(c) Exceptions.—This section shall not apply to the extent otherwise provided by section 712(d) (relating to contributed property) or section 751 (relating to unrealized receivables and inventory items).

“(d) Treatment of Passthrough Corporations With Accumulated Earnings and Profits.—For treatment of distributions by passthrough corporations which have accumulated earnings and profits, see section 772.

“SEC. 732. BASIS OF DISTRIBUTED PROPERTY OTHER THAN MONEY.

“The basis of property (other than money) distributed by a passthrough to an owner shall be the sum of—

“(1) the lesser of—

“(A) its adjusted basis to the passthrough immediately before such distribution but after application of section 731(b)(2), or
“(B) such owner’s adjusted basis in the passthrough determined immediately before such distribution, plus
“(2) any gain recognized by such owner under section 731(a)(2).

“SEC. 733. BASIS OF DISTRIBUTEE OWNER’S PASSTHROUGH INTEREST.

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

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

“(2) the amount of the basis to such owner of distributed property other than money, as determined under section 732.

“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED PASSTHROUGH PROPERTY.

“(a) In General.—In the case of any distribution to an owner, the passthrough shall adjust the basis of passthrough property such that each remaining owner’s net liquidation amount immediately after such distribution is equal to such owner’s net liquidation amount immediately before such distribution (but after taking into account any gain recognized under section 731(b)).
“(b) DISTRIBUTIONS OTHER THAN IN LIQUIDATION
OF AN OWNER’S INTEREST.—In the case of any distribution to an owner other than in liquidation of such owner’s interest, proper adjustment shall be made under subsection (a) with respect to such owner to take into account—

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

“(2) the amount of any loss which would be recognized by such owner if such owner sold the property distributed at fair market value immediately after such distribution.

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

“(d) ALLOCATION OF BASIS.—

“(1) DECREASES IN BASIS.—

“(A) IN GENERAL.—Any decrease in the adjusted basis of passthrough property which is required under this section—
“(i) shall be made first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property’s unrealized depreciation), and

“(ii) then, to the extent such decrease is not allocated under clause (i), in proportion to their respective adjusted bases (as adjusted under clause (i)).

“(B) Treatment of Unrealized Receivables and Inventory.—Clauses (i) and (ii) shall each be applied first with respect to property other than unrealized receivables (as defined in section 751(c)) and inventory (as defined in section 751(d)) to the extent thereof.

“(C) Treatment of Decreases in Excess of Basis.—If any such decrease is prevented by the absence of sufficient adjusted basis of passthrough property, each owner shall recognize gain in the amount of such owner’s distributive share of such prevented decrease. Such gain shall be treated as gain from the sale of the owner’s passthrough interest.

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

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

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

“(iii) then, to the extent such increase is not allocated under clause (ii), in proportion to their respective fair market values.

“(B) TREATMENT OF INCREASE WHERE LACK OF PROPERTY.—If any such increase is prevented by the absence of property to which clauses (ii) and (iii) of subparagraph (A) apply, each owner shall recognize a loss in the amount of such owner’s distributive share of such pre-
vented increase. Such loss shall be treated as a loss from the sale of the owner’s passthrough interest.

“(e) No Allocation of Basis Decrease to Stock of C Corporation Owner.—In making an allocation under subsection (d) of any decrease in the adjusted basis of passthrough property required under subsection (a)—

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

“(2) any amount not allocable to stock by reason of paragraph (1) shall be allocated under subsection (d) to other passthrough property.

Gain shall be recognized by the passthrough to the extent that the amount required to be allocated to other passthrough property under paragraph (2) exceeds the aggregate adjusted basis of such other property immediately before the allocation required by subsection (a).
SEC. 735. CORRESPONDING ADJUSTMENT TO BASIS OF PROPERTIES HELD BY LOWER-TIER PASSTHROUGH IN CASE OF UPPER-TIER PASSTHROUGH BASIS ADJUSTMENTS.

“(a) Distributions by Upper-tier Passthrough.—In the case of any distribution of property to an owner by an upper-tier passthrough, if such distribution results in an adjustment in the upper-tier passthrough’s adjusted basis in an interest in a lower-tier passthrough under section 734, then such lower-tier passthrough shall make a corresponding adjustment to the adjusted basis of its passthrough property.

“(b) Distributions of Interests in Lower-tier Passthrough.—In the case of any distribution of an interest in a lower-tier passthrough by an upper-tier passthrough—

“(1) if the adjusted basis of such interest in the hands of the upper-tier passthrough (determined immediately before such distribution) exceeds the adjusted basis of such interest in the hands of the distributee owner (determined immediately after such distribution), then such lower-tier passthrough shall decrease the adjusted basis of its passthrough property by the amount of such excess, or

“(2) if the adjusted basis of such interest in the hands of the distributee owner (determined imme-
diately after such distribution) exceeds the adjusted basis of such interest in the hands of the upper-tier passthrough (determined immediately before such distribution), then such lower-tier passthrough shall increase the adjusted basis of its passthrough property by the amount of such excess.

“(c) Dispositions of Interests in Upper-Tier Passthrough.—In the case of a disposition of an interest in an upper-tier passthrough which holds an interest in a lower-tier passthrough, if there is an adjustment to the adjusted basis of the lower-tier passthrough under section 743, then such lower-tier passthrough shall make a corresponding adjustment to the adjusted basis of its passthrough property.

“(d) Multi-Tiered Passthroughs.—In the case of any adjustment under subsection (a), (b), or (e) in the adjusted basis of an interest in another passthrough, such other passthrough shall make a corresponding adjustment in the adjusted basis of its passthrough property.

“(e) Allocation of Basis; Recognition of Gain.—In the case of any adjustment in the adjusted basis of passthrough property—

“(1) under subsection (a), (b), (e), or (d), such adjustment shall be made only with respect to the upper-tier passthrough’s proportionate share (as de-
termined under section 743(a)) of the adjusted basis of the lower-tier passthrough’s property,

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

“(3) under subsection (c) (or so much of subsection (d) as relates to such subsection), rules similar to the rules of section 743(b) shall apply.

“(f) REPORTING.—In the case of any adjustment in the adjusted basis of passthrough property by a lower-tier passthrough under this section by reason of a distribution by, or a disposition of an interest in, an upper-tier passthrough, such upper-tier passthrough shall furnish (in such manner as the Secretary shall prescribe) to such lower-tier passthrough such information as is necessary to enable such lower-tier passthrough to make such adjustment.

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

“(1) UPPER-TIER PASSTHROUGH.—The term ‘upper-tier passthrough’ means a passthrough owning an interest in another passthrough.

“(2) LOWER-TIER PASSTHROUGH.—The term ‘lower-tier passthrough’ means the passthrough re-
ferred to in paragraph (1) an interest in which is
owned by the upper-tier passthrough.

“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.

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

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

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

“SEC. 742. BASIS OF TRANSFEREE OWNER’S PASSTHROUGH
INTEREST.

“The basis of a passthrough interest acquired other
than by contribution shall be determined under part II of
subchapter O.
“SEC. 743. ADJUSTMENT TO BASIS OF PASSTHROUGH PROPERTY.

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

“(1) increase the adjusted basis of the passthrough property by the excess of the basis to the transferee owner of his passthrough interest over his proportionate share of the adjusted basis of the passthrough property, or

“(2) decrease the adjusted basis of the passthrough property by the excess of the transferee owner’s proportionate share of the adjusted basis of the passthrough property over the basis of his passthrough interest.

Under regulations prescribed by the Secretary, such increase or decrease shall constitute an adjustment to the basis of passthrough property with respect to the transferee owner only. An owner’s proportionate share of the adjusted basis of passthrough property shall be determined in accordance with his economic interest in the passthrough and, in the case of property contributed to the passthrough by an owner, section 712(d) (relating to contributed property) shall apply in determining such share. In the case of an adjustment under this subsection to the basis of passthrough property subject to depletion,
any depletion allowable shall be determined separately for
the transferee owner with respect to his passthrough inter-
est in such property.

“(b) ALLOCATION OF BASIS.—

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

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

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

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

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

“(B) any other property of the pass-
through,
shall be allocated to passthrough property of a like character except that the basis of any such passthrough property shall not be reduced below zero.

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

Sec. 751. Unrealized receivables and inventory items.
Sec. 752. Treatment of certain liabilities.

“SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

“(a) Sale or Exchange of Interest in Passthrough.—The amount of any money, or the fair market value of any property, received by a transferor owner in exchange for all or a part of his passthrough interest attributable to—

“(1) unrealized receivables of the passthrough, or

“(2) inventory items of the passthrough,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

“(b) Certain Distributions Treated as Sales or Exchanges.—

“(1) In general.—To the extent an owner receives in a distribution—

“(A) passthrough property which is—

“(i) unrealized receivables, or

“(ii) inventory items,
in exchange for all or a part of his interest in other passthrough property (including money), or

“(B) passthrough property (including money) other than property described in subparagraph (A)(i) or (ii) in exchange for all or a part of his interest in passthrough property described in subparagraph (A)(i) or (ii), such transactions shall, under regulations prescribed by the Secretary, be considered as a sale or exchange of such property between the distributee and the passthrough (as constituted after the distribution).

“(2) EXCEPTIONS.—Paragraph (1) shall not apply to a distribution of property which the distributee contributed to the passthrough.

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

“(1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or
“(2) services rendered, or to be rendered.

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

“(d) INVENTORY ITEMS.—For purposes of this subchapter, the term ‘inventory items’ means—

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

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

“(3) any other property held by the passthrough that, if held by the selling or distributee owner, would be considered property of the type described in paragraph (1) or (2).

“(e) LIMITATION ON TAX ATTRIBUTABLE TO DEEMED SALES OF SECTION 1248 STOCK.—For purposes of applying this section and sections 731 and 741 to any amount resulting from the reference to section 1248(a)
in the second sentence of subsection (c), in the case of an individual, the tax attributable to such amount shall be limited in the manner provided by subsection (b) of section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporation).

“(f) Special Rules in the Case of Tiered Passthroughs, etc.—In determining whether property of a passthrough is—

“(1) an unrealized receivable, or

“(2) an inventory item,

such passthrough shall be treated as owning its proportionate share of the property of any other passthrough in which it is an owner. Under regulations, rules similar to the rules of the preceding sentence shall also apply in the case of interests in trusts.

“SEC. 752. TREATMENT OF CERTAIN LIABILITIES.

“(a) Increase in Owner’s Liabilities.—Any increase in an owner’s share of the liabilities of a passthrough, or any increase in an owner’s individual liabilities by reason of the assumption by such owner of passthrough liabilities, shall be considered as a contribution of money by such owner to the passthrough.

“(b) Decrease in Owner’s Liabilities.—Any decrease in an owner’s share of the liabilities of a passthrough, or any decrease in an owner’s individual liability...
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.
“(c) Passthrough Item.—For purposes of this subchapter, the term ‘passthrough item’ means each item, contribution, and tax described in section 711(a) with respect to which an owner may receive a distributive share.

“(d) Distributive Share.—Notwithstanding any other provision of this subchapter, an owner’s distributive share (when expressed as a percentage)—

“(1) cannot be less than zero, and

“(2) must, when added to the distributive share of all other owners, total 100 percent of the allocated item.

“(e) Ownership Agreement.—For purposes of this subchapter, an ownership agreement includes any modifications of the agreement made prior to, or at, the time prescribed by law for the filing of the passthrough return for the taxable year (not including extensions) which are agreed to by all the owners, or which are adopted in such other manner as may be provided by the agreement.

“(f) Liquidation of an Owner’s Passthrough Interest.—For purposes of this subchapter, the term ‘liquidation of an owner’s passthrough interest’ means the termination of an owner’s entire passthrough interest by means of a distribution, or a series of distributions, to the owner by the passthrough.
“(g) C CORPORATION.—For purposes of this title, the term ‘C corporation’ means, with respect to any taxable year, any corporation which is not a passthrough for such taxable year.

“SEC. 762. TRANSACTIONS BETWEEN OWNER AND PASSTHROUGH.

“(a) OWNERS NOT ACTING IN CAPACITY AS OWNERS.—

“(1) IN GENERAL.—If an owner engages in a transaction with a passthrough other than in his capacity as an owner of such passthrough, the transaction shall, except as otherwise provided in this section, be considered as occurring between the passthrough and one who is not an owner.

“(2) TREATMENT OF PAYMENTS TO OWNERS FOR PROPERTY OR SERVICES.—Under regulations prescribed by the Secretary—

“(A) TREATMENT OF CERTAIN SERVICES AND TRANSFERS OF PROPERTY.—If—

“(i) an owner performs services for a passthrough or transfers property to a passthrough,

“(ii) there is a related direct or indirect distribution to such owner, and
“(iii) the performance of such services (or such transfer) and the distribution, when viewed together, are properly characterized as a transaction occurring between the passthrough and an owner acting other than in his capacity as an owner of the passthrough, such allocation and distribution shall be treated as transaction described in paragraph (1).

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

“(i) there is a direct or indirect transfer of money or other property by an owner to a passthrough,

“(ii) there is a related direct or indirect transfer of money or other property by the passthrough to the owner (or another owner), and

“(iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property, such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more owners acting
other than in their capacity as owners of the passthrough.

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

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

“(1) LOSSES DISALLOWED.—No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the passthrough), directly or indirectly, between—

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

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

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1). For purposes of section 267(a)(2), passthroughs described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b).
(2) GAINS TREATED AS ORDINARY INCOME.—

In the case of a sale or exchange, directly or indirectly, of property, which, in the hands of the transferee, is property other than a capital asset as defined in section 1221—

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

(B) between two passthroughs in which the same persons own, directly or indirectly, more than 50 percent of the passthrough interest,

any gain recognized shall be considered as ordinary income.

(3) OWNERSHIP OF A PASSTHROUGH INTEREST.—For purposes of paragraphs (1) and (2) of this subsection, the ownership of a passthrough interest shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c).

SEC. 763. TAXABLE YEARS OF OWNER AND PASSTHROUGH.

(a) YEAR IN WHICH PASSTHROUGH INCOME IS INCLUDIBLE.—In computing the taxable income of an owner for a taxable year, the inclusions required by section 711 with respect to a passthrough shall be based on the pass-
through items of the passthrough for any taxable year of
the passthrough ending within or with the taxable year
of the owner.

“(b) TAXABLE YEAR OF A PASSTHROUGH.—

“(1) PASSTHROUGH TAXABLE YEAR.—

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

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

“(i) is a year ending December 31, or

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

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

“(2) OWNER’S TAXABLE YEAR.—

“(A) GENERAL RULE.—An owner may not
change to a taxable year other than that of a
passthrough in which he is a principal owner
unless he establishes, to the satisfaction of the
Secretary, a business purpose therefor.
“(B) Principal owner.—For the purpose of this subsection, a principal owner is an owner having a passthrough interest of 5 percent or more.

“(c) Closing of Passthrough Year.—

“(1) General rule.—Except in the case of a termination of a passthrough and except as provided in paragraph (2) of this subsection, the taxable year of a passthrough shall not close as the result of the death of an owner, the entry of a new owner, the liquidation of an owner’s passthrough interest, or the sale or exchange of an owner’s passthrough interest.

“(2) Treatment of dispositions.—

“(A) Disposition of entire passthrough interest.—The taxable year of a passthrough shall close with respect to an owner whose entire passthrough interest terminates (whether by reason of death, liquidation, or otherwise).

“(B) Disposition of less than entire passthrough interest.—The taxable year of a passthrough shall not close (other than at the end of a passthrough’s taxable year as determined under subsection (b)(1)) with respect to an owner who sells or exchanges less than his
entire passthrough interest or with respect to an owner whose passthrough interest is reduced (whether by entry of a new owner, partial liquidation of an owner’s passthrough interest, gift, or otherwise).

“(d) Determination of Distributive Share When Owner’s Interest Changes.—

“(1) In general.—Except as provided in paragraphs (2) and (3), if during any taxable year of the passthrough there is a change in any owner’s interest in the passthrough, each owner’s distributive share of any item of income, gain, loss, deduction, or credit of the passthrough for such taxable year shall be determined by the use of any method prescribed by the Secretary by regulations which takes into account the varying interests of the owners in the passthrough during such taxable year.

“(2) Certain cash basis items prorated over period to which attributable.—

“(A) In general.—If during any taxable year of the passthrough there is a change in any owner’s interest in the passthrough, then (except to the extent provided in regulations) each owner’s distributive share of any allocable cash basis item shall be determined—
“(i) by assigning the appropriate portion of such item to each day in the period to which it is attributable, and

“(ii) by allocating the portion assigned to any such day among the owners in proportion to their interests in the passthrough at the close of such day.

“(B) Allocable Cash Basis Item.—For purposes of this paragraph, the term ‘allocable cash basis item’ means any of the following items with respect to which the passthrough uses the cash receipts and disbursements method of accounting:

“(i) Interest.

“(ii) Taxes.

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

“(iv) Any other item of a kind specified in regulations prescribed by the Secretary as being an item with respect to which the application of this paragraph is appropriate to avoid significant misstatements of the income of the owners.

“(C) Items Attributable to Periods Not Within Taxable Year.—If any portion of
any allocable cash basis item is attributable to—

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

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

such portion shall be assigned under subparagraph (A)(i) to the last day of the taxable year.

“(D) Treatment of Deductible Items Attributable to Prior Periods.—If any portion of a deductible cash basis item is assigned under subparagraph (C)(i) to the first day of any taxable year—

“(i) such portion shall be allocated among persons who are owners in the passthrough during the period to which such portion is attributable in accordance with their varying interests in the passthrough during such period, and

“(ii) any amount allocated under clause (i) to a person who is not an owner in the passthrough on such first day shall be capitalized by the passthrough and
treated in the manner provided for in section 743(b).

“(3) Items attributable to interest in lower-tier passthrough prorated over entire taxable year.—If—

“(A) during any taxable year of the passthrough there is a change in any owner’s interest in the passthrough (hereinafter in this paragraph referred to as the ‘upper-tier passthrough’), and

“(B) such passthrough is an owner in another passthrough (hereinafter in this paragraph referred to as the ‘lower-tier passthrough’),

then (except to the extent provided in regulations) each owner’s distributive share of any item of the upper-tier passthrough attributable to the lower-tier passthrough shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of subparagraphs (C) and (D) of paragraph (2)) of each such item to the appropriate days during which the upper-tier passthrough is an owner in the lower-tier passthrough and by allocating the portion assigned to any such day among the owners in proportion to their inter-
ests in the upper-tier passthrough at the close of such day.

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

“SEC. 764. CONTINUITY OF PASSTHROUGH.

“(a) GENERAL RULE.—For purposes of this subchapter, an existing passthrough shall be considered as continuing if it is not terminated.

“(b) TERMINATION.—

“(1) GENERAL RULE.—For purposes of subsection (a), a passthrough shall be considered as terminated only if—

“(A) no part of any business, financial operation, or venture of the passthrough continues to be carried on by any of its owners in a passthrough, or

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

“(2) SPECIAL RULES.—

“(A) MERGER OR CONSOLIDATION.—In the case of the merger or consolidation of two or
more passthroughs, the resulting passthrough shall, for purposes of this section, be considered the continuation of any merging or consolidating passthrough whose owners possess a passthrough interest of more than 50 percent of the resulting passthrough.

“(B) DIVISION OF A PASSTHROUGH.—In the case of a division of a passthrough into two or more passthroughs, the resulting passthroughs (other than any resulting passthrough the owners of which had a passthrough interest of 50 percent or less of the prior passthrough) shall, for purposes of this section, be considered a continuation of the prior passthrough.

“SEC. 765. DISTRIBUTIONS OF PASSTHROUGH INTERESTS TREATED AS EXCHANGES.

“Except as otherwise provided in regulations, for purposes of—

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

“(2) section 764, and

“(3) any other provision of this subchapter specified in regulations prescribed by the Secretary, any distribution of a passthrough interest (not otherwise treated as an exchange) shall be treated as an exchange.
“PART V—RULES RELATING TO PASSTHROUGH CORPORATIONS

“Sec. 771. Coordination with subchapter C.

“Sec. 772. Treatment of distributions of passthrough corporations with accumulated earnings 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.

“SEC. 771. COORDINATION WITH SUBCHAPTER C.

“(a) Subchapter C Rules Generally Inapplicable.—Subchapter C shall not apply to a passthrough corporation and its shareholders.

“(b) No Carryover Between C Year and Passthrough Year.—

“(1) From C year to passthrough year.—No carryforward, and no carryback, arising for a taxable year for which a corporation is a C corporation may be carried to a taxable year for which such corporation is a passthrough corporation.

“(2) No Carryover From Passthrough Year.—No carryforward, and no carryback, shall arise at the corporate level for a taxable year for which a corporation is a passthrough corporation.

“(3) Treatment of passthrough year as elapsed year.—Nothing in paragraphs (1) and (2) shall prevent treating a taxable year for which a cor-
poration is a passthrough corporation as a taxable year for purposes of determining the number of taxable years to which an item may be carried back or carried forward.

“(c) COORDINATION WITH INVESTMENT CREDIT RECAPTURE.—

“(1) NO RECAPTURE BY REASON OF ELECTION.—Any election under section 703(a) shall be treated as a mere change in the form of conducting a trade or business for purposes of the second sentence of section 50(a)(4).

“(2) CORPORATION CONTINUES TO BE LIABLE.—Notwithstanding an election under section 703(a), a passthrough corporation shall continue to be liable for any increase in tax under section 49(b) or 50(a) attributable to credits allowed for taxable years for which such corporation was not a passthrough corporation.

“(d) CASH DISTRIBUTIONS DURING POST-TERMINATION TRANSITION PERIOD.—

“(1) IN GENERAL.—Any distribution of money by a C corporation with respect to its stock during a post-termination transition period shall be applied against and reduce the adjusted basis of the stock, to the extent that the amount of the distribution
does not exceed the accumulated adjustments account (within the meaning of section 772).

“(2) **Election to Distribute Earnings First.**—A corporation may elect to have paragraph (1) not apply to all distributions made during a post-termination transition period described in subsection (f)(1)(A). Such election shall not be effective unless all shareholders of the corporation to whom distributions are made by the corporation during such post-termination transition period consent to such election.

“(e) **Post-termination Transition Period.**—

“(1) **In General.**—For purposes of this section, the term ‘post-termination transition period’ means—

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

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

“(ii) the due date for filing the return for such last year as a passthrough corporation (including extensions),
“(B) the 120-day period beginning on the date of any determination pursuant to an audit of the taxpayer which follows the termination of the corporation’s election and which adjusts an item of income, gain, loss, deduction, or credit of the corporation arising during the pass-through period (as defined in section 772(d)(2)), and

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

“(2) Determination defined.—For purposes of paragraph (1), the term ‘determination’ means—

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

“(B) an agreement between the corporation and the Secretary that the corporation failed to qualify as a passthrough corporation.

“(3) Special rule for audit related post-termination transition periods.—Paragraph (1)(B) shall apply to a distribution described in subsection (e) only to the extent that the amount of such distribution does not exceed the aggregate in-
crease (if any) in the accumulated adjustments account (within the meaning of section 772(d)) by reason of the adjustments referred to in such paragraph.

“SEC. 772. TREATMENT OF DISTRIBUTIONS OF PASS-THROUGH CORPORATIONS WITH ACCUMULATED EARNING AND PROFITS.

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

“(1) exceeds the accumulated adjustments account, and

“(2) does not exceed the accumulated earnings and profits of the corporation,

shall be treated as a dividend.

“(b) ALLOCATION.—Except to the extent provided in regulations, if the distributions during the taxable year exceed the amount in the accumulated adjustments account at the close of the taxable year, for purposes of this section, the balance of such account shall be allocated among such distributions in proportion to their respective sizes.
“(c) Certain Adjustments Taken Into Account.—Subsection (a) shall be applied by properly taking into account—

“(1) the adjustments to the basis of the shareholder’s stock described in section 713, and

“(2) the adjustments to the accumulated adjustments account which are required by subsection (d)(1).

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

“(d) Definitions and Special Rules.—For purposes of this section—

“(1) Accumulated Adjustments Account.—

“(A) In general.—Except as otherwise provided in this subparagraph, the term ‘accumulated adjustments account’ means an account of the passthrough corporation which is adjusted for the passthrough period in a manner similar to the adjustments under section 713 (except that no adjustment shall be made for income (and related expenses) which is exempt from tax under this title and the phrase
‘(but not below zero)’ shall be disregarded in section 713(2) and no adjustment shall be made for Federal taxes attributable to any taxable year in which the corporation was a C corporation.

“(B) Net loss for year disregarded.—

“(i) In general.—In applying this section to distributions made during any taxable year, the amount in the accumulated adjustments account as of the close of such taxable year shall be determined without regard to any net negative adjustment for such taxable year.

“(ii) Net negative adjustment.— For purposes of clause (i), the term ‘net negative adjustment’ means, with respect to any taxable year, the excess (if any) of—

“(I) the reductions in the account for the taxable year (other than for distributions), over

“(II) the increases in such account for such taxable year.
“(2) ACCUMULATED EARNINGS AND PROFITS.—

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

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

“(4) ELECTION TO DISTRIBUTE EARNINGS
FIRST.—

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

“(B) AFFECTED SHAREHOLDER.—For
purposes of subparagraph (A), the term ‘af-
fected shareholder’ means any shareholder to
whom a distribution is made by the pass-
through corporation during the taxable year.

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

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

“(b) AMOUNT OF TAX.—

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

“(2) NET OPERATING LOSS CARRYFORWARDS
FROM C YEARS ALLOWED.—Notwithstanding section
771(b)(1), any net operating loss carryforward aris-
ing in a taxable year for which the corporation was
a C corporation shall be allowed for purposes of this
section as a deduction against the net recognized
built-in gain of the passthrough corporation for the
taxable year. For purposes of determining the
amount of any such loss which may be carried to
subsequent taxable years, the amount of the net rec-
ognized built-in gain shall be treated as taxable in-
come. Rules similar to the rules of the preceding sentences of this paragraph shall apply in the case of a capital loss carryforward arising in a taxable year for which the corporation was a C corporation.

“(3) CREDITS.—

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

“(B) BUSINESS CREDIT CARRYFORWARDS FROM C YEARS ALLOWED.—Notwithstanding section 771(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11. A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation.

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

For purposes of section 1201(a)—
“(A) the tax imposed by subsection (a) shall be treated as if it were imposed by section 11, and

“(B) the amount of the net recognized built-in gain shall be treated as the taxable income.

“(c) LIMITATIONS.—

“(1) CORPORATIONS WHICH WERE ALWAYS PASSTHROUGH CORPORATIONS.—Subsection (a) shall not apply to any corporation if an election under section 703(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, a passthrough corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

“(2) LIMITATION ON AMOUNT OF NET RECOGNIZED BUILT-IN GAIN.—The amount of the net recognized built-in gain taken into account under this section for any taxable year shall not exceed the excess (if any) of—

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

“(B) the net recognized built-in gain for prior taxable years beginning in the recognition period.
“(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

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

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

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

“(2) NET RECOGNIZED BUILT-IN GAIN.—

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

“(i) the amount which would be the taxable income of the passthrough corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or

“(ii) such corporation’s taxable income for such taxable year (determined as provided in section 774(b)(1)(B)).
“(D) Carryover.—If, for any taxable year described in subparagraph (A), the amount referred to in clause (i) of subparagraph (A) exceeds the amount referred to in clause (ii) of subparagraph (A), such excess shall be treated as a recognized built-in gain in the succeeding taxable year. The preceding sentence shall not apply in the case of a corporation treated as a passthrough corporation under section 776 by reason of an election made before March 31, 1988.

“(3) Recognized built-in gain.—The term ‘recognized built-in gain’ means any gain recognized during the recognition period on the disposition of any asset except to the extent that the passthrough corporation establishes that—

“(A) such asset was not held by the passthrough corporation as of the beginning of the 1st taxable year for which it was a passthrough corporation, or

“(B) such gain exceeds the excess (if any)

of—

“(i) the fair market value of such asset as of the beginning of such 1st taxable year, over
“(ii) the adjusted basis of the asset as of such time.

“(4) Recognized built-in losses.—The term ‘recognized built-in loss’ means any loss recognized during the recognition period on the disposition of any asset to the extent that the passsthrough corporation establishes that—

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

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

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

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

“(5) Treatment of certain built-in items.—

“(A) Income items.—Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the 1st taxable year for which the corporation was a passsthrough corporation
shall be treated as a recognized built-in gain for
the taxable year in which it is properly taken
into account.

“(B) Deduction Items.—Any amount
which is allowable as a deduction during the
recognition period (determined without regard
to any carryover) but which is attributable to
periods before the 1st taxable year referred to
in subparagraph (A) shall be treated as a recog-
nized built-in loss for the taxable year for which
it is allowable as a deduction.

“(C) Adjustment to Net Unrealized
Built-in Gain.—The amount of the net unreal-
ized built-in gain shall be properly adjusted for
amounts which would be treated as recognized
built-in gains or losses under this paragraph if
such amounts were properly taken into account
(or allowable as a deduction) during the rec-
ognition period.

“(6) Treatment of Certain Property.—If
the adjusted basis of any asset is determined (in
whole or in part) by reference to the adjusted basis
of any other asset held by the passthrough corpora-
tion as of the beginning of the 1st taxable year re-
ferred to in paragraph (3)—
“(A) such asset shall be treated as held by
the passthrough corporation as of the beginning
of such 1st taxable year, and

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

“(7) RECOGNITION PERIOD.—

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

“(B) INSTALLMENT SALES.—If a pass-
through corporation sells an asset and reports
the income from the sale using the installment
method under section 453, the treatment of all
payments received shall be governed by the pro-
visions of this paragraph applicable to the tax-
able year in which such sale was made.
“(8) Treatment of Transfer of Assets from C Corporation to Passthrough Corporation.—

“(A) In general.—Except to the extent provided in regulations, if—

“(i) a passthrough corporation acquires any asset, and

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

then a tax is hereby imposed on any net recognized built-in gain attributable to any such assets for any taxable year beginning in the recognition period. The amount of such tax shall be determined under the rules of this section as modified by subparagraph (B).

“(B) Modifications.—For purposes of this paragraph, the modifications of this subparagraph are as follows:

“(i) In general.—The preceding paragraphs of this subsection shall be applied by taking into account the day on which the assets were acquired by the
passthrough corporation in lieu of the beginning of the 1st taxable year for which the corporation was a passthrough corporation.

“(ii) Subsection (c)(1) not to apply.—Subsection (c)(1) shall not apply.

“(9) Reference to 1st taxable year.—Any reference in this section to the 1st taxable year for which the corporation was a passthrough corporation shall be treated as a reference to the 1st taxable year for which the corporation was a passthrough corporation pursuant to its most recent election under section 703(a).

“(e) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section including regulations providing for the appropriate treatment of successor corporations.

“SEC. 774. TAX IMPOSED WHEN PASSIVE INVESTMENT INCOME OF CORPORATION HAVING ACCUMULATED EARNINGS AND PROFITS EXCEEDS 60 PERCENT OF GROSS RECEIPTS.

“(a) General rule.—If for the taxable year a passthrough corporation has—

“(1) accumulated earnings and profits at the close of such taxable year, and
“(2) gross receipts more than 60 percent of which are passive investment income, then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in section 11(b).

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

“(1) EXCESS NET PASSIVE INCOME.—

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

“(i) the amount by which the passive investment income for the taxable year exceeds 60 percent of the gross receipts for the taxable year, bears to

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

“(B) LIMITATION.—The amount of the excess net passive income for any taxable year shall not exceed the amount of the corporation’s taxable income for such taxable year as determined under section 63(a)—
“(i) without regard to the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures), and

“(ii) without regard to the deduction under section 172.

“(2) Net passive income.—The term ‘net passive income’ means—

“(A) passive investment income, reduced by

“(B) the deductions allowable under this chapter which are directly connected with the production of such income (other than deductions allowable under section 172 and part VIII of subchapter B).

“(3) Passive investment income defined.—

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

“(B) Exception for interest on notes from sales of inventory.—The term
‘passive investment income’ shall not include interest on any obligation acquired in the ordinary course of the corporation’s trade or business from its sale of property described in section 1221(a)(1).

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

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

“(E) Exception for Banks, etc.—In the case of a bank (as defined in section 581)
or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)), the term ‘passive investment income’ shall not include—

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

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

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

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

“(G) COORDINATION WITH SECTION 773.—The amount of passive investment income shall be determined by not taking into account any recognized built-in gain or loss of the pass-through corporation for any taxable year in the recognition period. Terms used in the preceding sentence shall have the same respective meanings as when used in section 773.

“(c) CREDITS NOT ALLOWABLE.—No credit shall be allowed under part IV of subchapter A of this chapter (other than section 34) against the tax imposed by subsection (a).

“(d) WAIVER OF TAX IN CERTAIN CASES.—If the pass-through corporation establishes to the satisfaction of the Secretary that—

“(1) it determined in good faith that it had no accumulated earnings and profits at the close of a taxable year, and

“(2) during a reasonable period of time after it was determined that it did have accumulated earn-
ings and profits at the close of such taxable year
such earnings and profits were distributed,
the Secretary may waive the tax imposed by subsection
(a) for such taxable year.

“SEC. 775. RECAPTURE OF LIFO BENEFITS.

“(a) IN GENERAL.—If—

“(1) a passthrough corporation was a C cor-
poration for the last taxable year before the first
taxable year for which the election under section
703(a) was effective, and

“(2) the corporation inventoried goods under
the LIFO method for such last taxable year,
the LIFO recapture amount shall be included in the gross
income of the corporation for such last taxable year (and
appropriate adjustments to the basis of inventory shall be
made to take into account the amount included in gross
income under this subsection).

“(b) ADDITIONAL TAX PAYABLE IN INSTALL-
MENTS.—

“(1) IN GENERAL.—Any increase in the tax im-
posed by this chapter by reason of this section shall
be payable in 4 equal installments.

“(2) DATE FOR PAYMENT OF INSTALLMENTS.—
The first installment under paragraph (1) shall be
paid on or before the due date (determined without
regard to extensions) for the return of the tax im-
posed by this chapter for the last taxable year for
which the corporation was a C corporation and the
3 succeeding installments shall be paid on or before
the due date (as so determined) for the corporation’s
return for the 3 succeeding taxable years.

“(3) NO INTEREST FOR PERIOD OF EXTEN-
sion.—Notwithstanding section 6601(b), for pur-
poses of section 6601, the date prescribed for the
payment of each installment under this subsection
shall be determined under this subsection.

“(c) LIFO RECAPTURE AMOUNT.—For purposes of
this section, the term ‘LIFO recapture amount’ means the
amount (if any) by which—

“(1) the inventory amount of the inventory
asset under the first-in, first-out method authorized
by section 471, exceeds

“(2) the inventory amount of such assets under
the LIFO method.

For purposes of the preceding sentence, inventory
amounts shall be determined as of the close of the last
taxable year referred to in subsection (a).

“(d) OTHER DEFINITIONS.—For purposes of this
section—
“(1) LIFO METHOD.—The term ‘LIFO method’ means the method authorized by section 472.

“(2) INVENTORY ASSETS.—The term ‘inventory assets’ means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

“(3) METHOD OF DETERMINING INVENTORY AMOUNT.—The inventory amount of assets under a method authorized by section 471 shall be determined—

“(A) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

“(B) if subparagraph (A) does not apply, by using cost or market, whichever is lower.

“(4) NOT TREATED AS MEMBER OF AFFILIATED GROUP.—Except as provided in regulations, the corporation referred to in subsection (a) shall not be treated as a member of an affiliated group with respect to the amount included in gross income under subsection (a).

“(e) SPECIAL RULE.—Sections 713(2)(B)(ii) and 771(c)(1) shall not apply with respect to any increase in the tax imposed by reason of this section.
“SEC. 776. APPLICATION OF PASSTHROUGH CORPORATION RULES TO PRE-EXISTING S CORPORATIONS.

“In the case of a corporation treated as having made the election under section 703(a) by reason of section 703(d)—

“(1) such election shall not be taken into account in determining the 1st taxable year for which the corporation was a passthrough corporation,

“(2) such corporation shall be treated for purposes of this chapter as a passthrough corporation for any taxable year for which such corporation had an election in effect under section 1362 (as in effect before its repeal), and

“(3) any election under such section 1362 shall be treated for purposes of this chapter as an election under section 703(a).”.

(d) WITHHOLDING.—

(1) IN GENERAL.—Chapter 24 is amended by adding at the end the following new subchapter:

“Subchapter B—Withholding on Distributive Share of Passthrough Income

“SEC. 3411. WITHHOLDING OF TAX ON OWNER'S DISTRIBUTIVE SHARE OF PASSTHROUGH INCOME.

“(a) IN GENERAL.—A passthrough shall pay (at such time and in such manner as the Secretary may provide),
with respect to each owner, a withholding tax under this section equal to \([x]\) percent of the excess (if any) of—

“(1) such owner’s distributive share of items of income and gain, over

“(2) such owner’s distributive share of items of deduction and loss.

“(b) Separate Application in Cases of Different Distributive Shares.—In the case of an owner which has a different distributive share with respect to capital gain rate items than with respect to ordinary items, this section shall be applied separately with respect to capital gain rate items and ordinary items.

“(c) Payment of Withholding Tax Treated as Distribution to Owner.—Except as provided in regulations, any withholding tax paid by a passthrough under subsection (a) with respect to any owner shall be treated as distributed to such owner by such passthrough on the earlier of—

“(1) the day on which such tax was paid by the passthrough, or

“(2) the last day of the passthrough’s taxable year for which such tax was paid.

“(d) Withholding Tax Collected in Same Manner as Estimated Taxes.—Except as otherwise provided by the Secretary, for purposes of section 6655—
“(1) the withholding tax imposed under this section shall be treated as a tax imposed by section 11, and

“(2) any passthrough required to pay such tax shall be treated as a corporation.

“(e) Definitions.—Terms used in this section which are also used in subchapter K of chapter 1 shall have the same meaning as when used in such subchapter.

“(f) Coordination With Withholding Tax on Foreign Partners’ Share of Effectively Connected Income.—This section shall not apply with respect to any foreign partner to which section 1446 applies.”.

(2) Credit to Owner.—Subpart C of part IV of subchapter A of chapter 1 is amended by inserting after section 33 the following new section:

“SEC. 33A. TAX WITHHELD ON OWNER’S DISTRIBUTIVE SHARE OF PASSTHROUGH INCOME.

“(a) In General.—In the case of any owner of a passthrough, there shall be allowed as a credit against the tax imposed by this subtitle the amount of withholding tax paid by such passthrough under section 3411 with respect to such owner.

“(b) Credit Allowed for Taxable Year of Owner in Which Passthrough Taxable Year
ENDS.—Such credit shall be allowed for the owner’s taxable year in which (or with which) the passthrough taxable year (with respect to which the distributive share of the owner was determined) ends.”.

(e) CONFORMING AMENDMENTS.—[to be provided]

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of passthroughs (as defined in section 702 of the Internal Revenue Code of 1986, as amended by this section) beginning after December 31, 2013.

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].