

United States Senate

FOR IMMEDIATE RELEASE
March 23, 2017

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Thune, Cardin Reintroduce Bill to Improve and Modernize S Corporations

WASHINGTON — U.S. Sens. John Thune (R-S.D.) and Ben Cardin (D-Md.), members of the tax-writing Senate Finance Committee, today reintroduced the S Corporation Modernization Act of 2017, [legislation](#) that would make several pro-growth reforms to help S corporations operate more easily, which would improve their ability to raise capital. S corporations were created in 1958, must be domestically owned, and are limited to 100 shareholders. This type of business has grown in popularity, particularly among small businesses, because of its simplicity and flexibility. S corporations are the most common form of business structure in America, with more than 4 million in existence today. Despite their popularity, relatively few reforms have been made to S corporations since their creation, which is why the Thune-Cardin bill would help modernize this part of the tax code.

“Family-owned small businesses are the backbone of the U.S. economy and are located in every corner of the country,” **said Thune**. “S corporations are a popular and effective business structure for small- and medium-sized businesses in industries ranging from manufacturing and construction to retail trade and agriculture. That’s why these common-sense reforms to S corporations are so important to South Dakota. There’s broad bipartisan agreement that our tax code is outdated and that pass-through businesses like S corporations must have a seat at the table as we work to reform the tax code. These incremental changes are an important step in the right direction.”

“S corporation businesses are critical to the well-being of the Maryland economy and account for more than half of our state’s private-sector workforce,” **said Cardin**. “Unfortunately, our federal tax code has not kept up with the increasingly important role that these types of companies play. The S Corporation Modernization Act contains much-needed changes to the tax treatment of S corporations, allowing them to better attract capital, create jobs, and make charitable investments in their communities.”

Highlights of the S Corporation Modernization Act:

Expansion of Qualifying Beneficiaries of an Electing Small Business Trust

This provision would allow a non-resident alien to be a qualified beneficiary of an Electing Small Business Trust (ESBT), which is a type of trust that is allowed to own shares in an S corporation. Currently, only U.S. citizens or U.S. residents can be shareholders of an S corporation. This provision would not change the direct ownership requirement, but it would allow a non-resident alien to get the benefits of S corporation ownership by being a beneficiary of the ESBT, while ensuring that any applicable taxes are paid by the ESBT.

Modifications to Passive Income Rules

The tax code currently imposes an additional tax on S corporations that previously converted from being a C corporation if more than 25 percent of the S corporation’s income is passive in nature (such as rents, royalties, dividends, interest

and annuities). The provision would implement a 2001 recommendation by the Joint Committee on Taxation (JCT) that this threshold be increased to 60 percent and that the rules be changed so that an S corporation paying this tax does not lose its S corporation status.

S Corporation IRA Shareholders

This provision would permit individuals to own shares in an S corporation through an individual retirement account (IRA). Current law allows for IRA ownership of S corporation stock, but only if the S corporation is a bank and the stock was held by the IRA as of October 22, 2004. As under current law, the IRA would be required to pay Unrelated Business Income Tax on its share of the S corporation's income. A significant percentage of banks are currently organized as S corporations.

Charitable Contributions for Electing Small Business Trusts

Under current law, ESBTs are allowed to own S corporation stock, but are not allowed a charitable deduction for certain donations that the S corporation may make to charitable organizations. Individual owners of an S corporation, however, are allowed the charitable deduction. This provision would treat individual shareholders and ESBTs the same by allowing ESBTs to claim the charitable deduction.

Basis Parity for S Corporation Assets

This provision would provide a basis adjustment for S corporation assets upon the death of an S corporation shareholder similar to the adjustment available to a partnership when one of its partners passes away. The provision, however, would allow for the basis adjustment in a way that would minimize complex and time-consuming recordkeeping and reporting requirements. As a result, upon the death of a shareholder, the heir would have a 15-year amortization deduction attributable to his or her share of the appreciation of the S corporation's assets at the time that the original shareholder died.

Streamlined Procedures for S Corporation Elections

This provision would streamline the process for a corporation to elect to be treated as an S corporation by allowing the election to be made on the first tax return that the business files as an S corporation. Under current law, a corporation must file a separate election form with the IRS within two and half months after the close of its first year operating as an S corporation. The provision also would streamline the process for S corporations to create qualifying subsidiaries and for certain trusts to qualify to hold S corporation shares.

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