

THE GENERAL ASSEMBLY OF PENNSYLVANIA

HOUSE BILL

No. 220

Session of
1985

INTRODUCED BY DORR, CAPPABIANCA, F. E. TAYLOR, L. E. SMITH,
GALLEN, PRESTON, HALUSKA, BURD, LESCOVITZ, LIVENGOD,
SEVENTY, GREENWOOD, VAN HORNE, GEIST, BELFANTI, KENNEDY,
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HONAMAN, REBER, NAHILL, CORNELL, BLACK, CARLSON, GRUPPO,
SCHULER, JACKSON, ROBBINS, DAVIES, LANGTRY, BOYES, FARGO,
SCHEETZ, MERRY, FOX AND DISTLER, FEBRUARY 11, 1985

REFERRED TO COMMITTEE ON BUSINESS AND COMMERCE,
FEBRUARY 11, 1985

AN ACT

1 Amending the act of March 4, 1971 (P.L.6, No.2), entitled "An
2 act relating to tax reform and State taxation by codifying
3 and enumerating certain subjects of taxation and imposing
4 taxes thereon; providing procedures for the payment,
5 collection, administration and enforcement thereof; providing
6 for tax credits in certain cases; conferring powers and
7 imposing duties upon the Department of Revenue, certain
8 employers, fiduciaries, individuals, persons, corporations
9 and other entities; prescribing crimes, offenses and
10 penalties," exempting income derived from the sale of small
11 businesses from personal income tax and corporate net income
12 tax under certain conditions.

13 The General Assembly of the Commonwealth of Pennsylvania
14 hereby enacts as follows:

15 Section 1. Section 301(s.1) of the act of March 4, 1971
16 (P.L.6, No.2), known as the Tax Reform Code of 1971, added March
17 13, 1974 (P.L.179, No.32), is amended and the section is amended
18 by adding clauses to read:

19 Section 301. Definitions.--The following words, terms and

1 phrases when used in this article shall have the meaning
2 ascribed to them in this section except where the context
3 clearly indicates a different meaning. Any reference in this
4 article to the Internal Revenue Code shall include the Internal
5 Revenue Code of 1954, as amended to the date on which this
6 article is effective:

7 * * *

8 (a.1) "Adjusted sales price" means the amount realized from
9 the sale of a qualifying ownership interest in a small business,
10 reduced by the aggregate of the ordinary and necessary expenses
11 incurred in the sale thereof, if the expenses are: (i) paid on
12 or before the thirtieth day after the sale of the qualifying
13 ownership interest; and (ii) not otherwise available as
14 deductions under this article.

15 * * *

16 (o.3) "Qualifying ownership interest" means an ownership
17 interest in a small business located in this Commonwealth which
18 is the taxpayer's principal business and which comprises: (i)
19 the total ownership of a small business; (ii) the taxpayer's
20 total interest as a partner in the case of a partnership; (iii)
21 the shareholder's total share holdings in the case of a
22 Pennsylvania S corporation; or (iv) one hundred per cent of the
23 issued and outstanding capital stock of a corporation as defined
24 in Article IV.

25 * * *

26 (s.1) "Small business" means a business enterprise operated
27 by the taxpayer as his principal business or a partnership,
28 limited partnership, a Pennsylvania S corporation, corporation,
29 association or other entity, located in this Commonwealth, in
30 which the taxpayer holds a qualifying ownership interest which,

1 together with its parents, subsidiaries or affiliates employs in
2 the aggregate less than two hundred employees on an annual basis.

3 * * *

4 [(s.1)] (s.3) "Special tax provisions" means a refund or
5 forgiveness of all or part of the claimant's liability under the
6 provisions of this article.

7 * * *

8 Section 2. Section 303(a)(3) of the act, amended June 17,
9 1974 (P.L.325, No.105), is amended to read:

10 Section 303. Classes of Income.--(a) The classes of income
11 referred to above are as follows:

12 * * *

13 (3) Net gains or income from disposition of property. Net
14 gains or net income, less net losses, derived from the sale,
15 exchange or other disposition of property, including real or
16 personal, whether tangible or intangible as determined in
17 accordance with accepted accounting principles and practices.
18 For the purpose of this act, for the determination of the basis
19 of any property, real and personal, if acquired prior to June 1,
20 1971, the date of acquisition shall be adjusted to June 1, 1971
21 as if the property had been acquired on that date. If the
22 property was acquired after June 1, 1971, the actual date of
23 acquisition shall be used in determination of the basis.

24 The term "net gains or income" shall not include gains or
25 income derived from obligations which are statutorily free from
26 State or local taxation under any other act of the General
27 Assembly of the Commonwealth of Pennsylvania or under the laws
28 of the United States. The term "sale, exchange or other
29 disposition" shall not include the exchange of stock or
30 securities in a corporation a party to a reorganization in

1 pursuance of a plan of reorganization, solely for stock or
2 securities in such corporation or in another corporation a party
3 to the reorganization and the transfer of property to a
4 corporation by one or more persons solely in exchange for stock
5 or securities in such corporation if immediately after the
6 exchange such person or persons are in control of the
7 corporation. For purposes of this clause, stock or securities
8 issued for services shall not be considered as issued in return
9 for property.

10 For purposes of this clause, the term "reorganization"
11 means--

12 (i) a statutory merger or consolidation;

13 (ii) the acquisition by one corporation, in exchange solely
14 for all or a part of its voting stock (or in exchange solely for
15 all or a part of the voting stock of a corporation which is in
16 control of the acquiring corporation) of stock of another
17 corporation if, immediately after the acquisition, the acquiring
18 corporation has control of such other corporation (whether or
19 not such acquiring corporation had control immediately before
20 the acquisition);

21 (iii) the acquisition by one corporation, in exchange solely
22 for all or a part of its voting stock (or in exchange solely for
23 all or a part of the voting stock of a corporation which is in
24 control of the acquiring corporation), of substantially all of
25 the properties of another corporation, but in determining
26 whether the exchange is solely for stock the assumption by the
27 acquiring corporation of a liability of the other, or the fact
28 that property acquired is subject to a liability, shall be
29 disregarded;

30 (iv) a transfer by a corporation of all or a part of its

1 assets to another corporation if immediately after the transfer
2 the transferor, or one or more of its shareholders (including
3 persons who were shareholders immediately before the transfer),
4 or any combination thereof, is in control of the corporation to
5 which the assets are transferred;

6 (v) a recapitalization;

7 (vi) a mere change in identity, form, or place of
8 organization however effected; or

9 (vii) the acquisition by one corporation, in exchange for
10 stock of a corporation (referred to in this subclause as
11 "controlling corporation") which is in control of the acquiring
12 corporation, of substantially all of the properties of another
13 corporation which in the transaction is merged into the
14 acquiring corporation shall not disqualify a transaction under
15 subclause (i) if such transaction would have qualified under
16 subclause (i) if the merger had been into the controlling
17 corporation, and no stock of the acquiring corporation is used
18 in the transaction;

19 (viii) a transaction otherwise qualifying under subclause
20 (i) shall not be disqualified by reason of the fact that stock
21 of a corporation (referred to in this subclause as the
22 "controlling corporation") which before the merger was in
23 control of the merged corporation is used in the transaction, if
24 after the transaction, the corporation surviving the merger
25 holds substantially all of its properties and of the properties
26 of the merged corporation (other than stock of the controlling
27 corporation distributed in the transaction); and in the
28 transaction, former shareholders of the surviving corporation
29 exchanged, for an amount of voting stock of the controlling
30 corporation, an amount of stock in the surviving corporation

1 which constitutes control of such corporation.

2 For purposes of this clause, the term "control" means the
3 ownership of stock possessing at least eighty per cent of the
4 total combined voting power of all classes of stock entitled to
5 vote and at least eighty per cent of the total number of shares
6 of all other classes of stock of the corporation.

7 For purposes of this clause, the term "a party to a
8 reorganization" includes a corporation resulting from a
9 reorganization, and both corporations, in the case of a
10 reorganization resulting from the acquisition by one corporation
11 of stock or properties of another. In the case of a
12 reorganization qualifying under subclause (i) by reason of
13 subclause (vii) the term "a party to a reorganization" includes
14 the controlling corporation referred to in such subclause (vii).

15 Notwithstanding any provisions hereof, upon every such
16 exchange or conversion, the taxpayer's base for the stock or
17 securities received shall be the same as the taxpayer's actual
18 or attributed base for the stock, securities or property
19 surrendered in exchange therefor.

20 Except where a taxpayer's adjusted sales price of a former
21 qualifying ownership interest in a small business exceeds the
22 taxpayer's cost of purchasing the new qualifying ownership
23 interest in a small business, the term "net gains or income from
24 disposition of property" shall not include any gain derived from
25 the sale of a qualifying ownership interest in a small business,
26 if within a period commencing two years before the date of the
27 sale and ending two years after the date, a qualifying ownership
28 in a new small business is purchased by the taxpayer.

29 For purposes of this act--

30 (i) an exchange by a taxpayer of a qualifying ownership

interest in a small business for another qualifying ownership interest shall be treated as a sale of the interest and the acquisition of a qualifying ownership interest in a small business on the exchange of another qualifying business shall be treated as a purchase of the interest;

(ii) no gain on the sale of a qualifying ownership interest in a small business shall be excluded from taxable income under this act if the new qualifying ownership interest is purchased before the date of sale of the old qualifying ownership interest and sold or otherwise disposed of before the date of sale of the old qualifying ownership interest on disposition of a qualifying ownership interest in a small business;

(iii) the basis for determining the net gain or income shall be the value of all consideration paid in purchasing the qualifying ownership interest less any gain excluded from taxation pursuant to the provisions of this subsection in the immediately preceding sale made which invoked these provisions.

* * *

Section 3. Section 401(3) of the act is amended by adding a subclause to read:

Section 401. Definitions.--The following words, terms, and phrases, when used in this article, shall have the meaning ascribed to them in this section, except where the context clearly indicates a different meaning:

* * *

(3) "Taxable income." * * *

5. (a) In the event a qualifying ownership interest in a small business is sold on or after the effective date of this act, and within a period beginning two years before the date of the sale and ending two years after the date, a new qualifying

ownership interest in a small business is purchased by a corporation, gain from the sale shall not be included in "taxable income," except to the extent that the corporation's adjusted sales price of the old qualifying ownership interest exceeds the corporation's cost of purchasing the new qualifying ownership interest in a small business.

(b) For purposes of this subclause, the term "qualifying ownership interest" shall mean an ownership interest in a small business which is the corporation's principal business and which comprises (i) the total ownership of a small business; (ii) the corporation's total interest as a partner, in the case of a partnership; (iii) the taxpayer's total shareholdings in the case of a Pennsylvania S corporation; (iv) one hundred per cent of the issued and outstanding capital stock in the case of a corporation. The term "small business" shall mean a business enterprise operated by the corporation as its principal business or a partnership, limited partnership, corporation, association or other business entity in which the corporation holds a qualifying ownership interest which, together with parents, subsidiaries or affiliates employs in the aggregate less than two hundred employees on an annual basis.

The term "adjusted sales price" means the amount realized from the sale of a qualifying ownership interest in a small business, reduced by the aggregate of the necessary and ordinary expenses incurred in the sale, provided the expenses are, (i) paid on or before the thirtieth day after the sale of the qualifying ownership interest; (ii) not otherwise available as deductions in computing taxable income under this article; (iii) not taken into account in computing the amount realized from the sale of the old qualifying ownership interest.

1 (c) For purposes of this section: (i) an exchange by the
2 corporation of a qualifying ownership interest in a small
3 business for another qualifying ownership interest shall be
4 treated as a sale of such interest and the acquisition of a
5 qualifying ownership interest in a small business on the
6 exchange of another qualifying interest shall be treated as a
7 purchase of such interest; (ii) no gain on the sale of a
8 qualifying ownership interest in a small business shall be
9 excluded from taxable income under this act if the new
10 qualifying ownership interest is purchased before the date of
11 sale of the old qualifying ownership interest and sold or
12 otherwise disposed of before the date of sale of the old
13 qualifying ownership interest; (iii) the basis for determining
14 the net gain on the disposition of a qualifying ownership
15 interest in a small business shall be the value of all
16 consideration paid in purchasing a qualifying ownership interest
17 less any gain not included in taxable income pursuant to the
18 provisions of this subclause in the immediately preceding sale
19 made which invoked these provisions.

20 Section 4. This act shall apply to taxable years beginning
21 on or after January 1, 1986.

22 Section 5. This act shall take effect immediately.