

THE GENERAL ASSEMBLY OF PENNSYLVANIA

HOUSE BILL

No. 343 Session of
1989

INTRODUCED BY DORR, CAPPABIANCA, SERAFINI, GODSHALL, PRESTON,
HAGARTY, BURD, G. SNYDER, GEIST, HALUSKA, MORRIS, CLYMER,
DEMPSEY, NOYE, MOEHLMANN, FOX, DISTLER, LETTERMAN, WOGAN,
HERMAN, SEMMEL, S. H. SMITH, REBER, PHILLIPS, BUSH, ANGSTADT,
SCHEETZ, CORNELL, ALLEN, BILLOW, LANGTRY, BIRMELIN, HECKLER,
FLICK, FARMER, JOHNSON, BARLEY, BUNT, D. W. SNYDER, MERRY,
SCHULER, STAIRS, STUBAN, KENNEY, GLADECK, DIETTERICK,
E. Z. TAYLOR, HERSHEY, VROON, MICHLOVIC, BELFANTI, CIVERA,
RAYMOND, McVERRY, LASHINGER AND ROBBINS, FEBRUARY 8, 1989

REFERRED TO COMMITTEE ON BUSINESS AND COMMERCE, FEBRUARY 8, 1989

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 employes 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 July 13,
9 1987 (P.L.325, No.59), 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 At the election of the taxpayer, the term "net gains or
25 income" shall not include net gain in an amount not to exceed
26 one hundred thousand dollars (\$100,000), or a pro rata part of
27 one hundred thousand dollars (\$100,000) if the property is owned
28 by more than one taxpayer, from the sale or exchange of the
29 taxpayer's principal residence if the taxpayer has attained
30 fifty-five years of age before the date of the sale or exchange.

1 If the property is held by a husband and wife and they make a
2 joint return for the taxable year of the sale or exchange and
3 one spouse satisfies the age, ownership and use requirements of
4 this clause with respect to the property, then both husband and
5 wife shall be treated as satisfying the age, ownership and use
6 requirements of this clause. For purposes of this clause, in the
7 case of an unremarried individual whose spouse is deceased on
8 the date of sale or exchange of the property, if the deceased
9 spouse, during the five-year period ending on the date of sale
10 or exchange satisfied the holding and use requirements with
11 respect to such property, then such individual shall be treated
12 as satisfying holding and use requirements with respect to such
13 property. For the purposes of this clause, the term "sale or
14 exchange" shall include involuntary conversions such as the
15 destruction, theft, seizure, requisition or condemnation of the
16 property. For the purposes of this clause, the term "principal
17 residence" shall mean the property that has been owned and used
18 by the taxpayer as his principal residence for periods
19 aggregating three years or more during the five-year period
20 ending on the date of the sale or exchange. In the case of
21 property only a portion of which, during the five-year period
22 ending on the date of the sale or exchange, has been owned or
23 used by the taxpayer as the taxpayer's principal residence for
24 periods aggregating three years or more, this section shall
25 apply with respect to so much of the gain from the sale or
26 exchange of such property as is determined under regulations
27 prescribed by the department to be attributable to the portion
28 of the property so owned and used by the taxpayer. The term
29 "used" shall include time the property was not used for rental
30 purposes and was unoccupied by the taxpayer due to the taxpayer

1 being n a hospital, nursing home or personal care facility, or
2 for a period of less than ninety consecutive days. The
3 provisions of this clause shall not apply to any sale or
4 exchange made prior to July 1, 1987. An election under this
5 clause may be made or revoked at any time before the expiration
6 of the period for making a claim for a refund of the tax imposed
7 by this article for the taxable year in which the sale or
8 exchange occurred. The provisions of this clause shall be used
9 only once during the lifetime of the taxpayer.

10 The term "net gains or income" shall not include gains or
11 income derived from obligations which are statutorily free from
12 State or local taxation under any other act of the General
13 Assembly of the Commonwealth of Pennsylvania or under the laws
14 of the United States. The term "sale, exchange or other
15 disposition" shall not include the exchange of stock or
16 securities in a corporation a party to a reorganization in
17 pursuance of a plan of reorganization, solely for stock or
18 securities in such corporation or in another corporation a party
19 to the reorganization and the transfer of property to a
20 corporation by one or more persons solely in exchange for stock
21 or securities in such corporation if immediately after the
22 exchange such person or persons are in control of the
23 corporation. For purposes of this clause, stock or securities
24 issued for services shall not be considered as issued in return
25 for property.

26 For purposes of this clause, the term "reorganization"
27 means--

28 (i) a statutory merger or consolidation;

29 (ii) the acquisition by one corporation, in exchange solely
30 for all or a part of its voting stock (or in exchange solely for

1 all or a part of the voting stock of a corporation which is in
2 control of the acquiring corporation) of stock of another
3 corporation if, immediately after the acquisition, the acquiring
4 corporation has control of such other corporation (whether or
5 not such acquiring corporation had control immediately before
6 the acquisition);

7 (iii) the acquisition by one corporation, in exchange solely
8 for all or a part of its voting stock (or in exchange solely for
9 all or a part of the voting stock of a corporation which is in
10 control of the acquiring corporation), of substantially all of
11 the properties of another corporation, but in determining
12 whether the exchange is solely for stock the assumption by the
13 acquiring corporation of a liability of the other, or the fact
14 that property acquired is subject to a liability, shall be
15 disregarded;

16 (iv) a transfer by a corporation of all or a part of its
17 assets to another corporation if immediately after the transfer
18 the transferor, or one or more of its shareholders (including
19 persons who were shareholders immediately before the transfer),
20 or any combination thereof, is in control of the corporation to
21 which the assets are transferred;

22 (v) a recapitalization;

23 (vi) a mere change in identity, form, or place of
24 organization however effected; [or]

25 (vii) the acquisition by one corporation, in exchange for
26 stock of a corporation (referred to in this subclause as
27 "controlling corporation") which is in control of the acquiring
28 corporation, of substantially all of the properties of another
29 corporation which in the transaction is merged into the
30 acquiring corporation shall not disqualify a transaction under

1 subclause (i) if such transaction would have qualified under
2 subclause (i) if the merger had been into the controlling
3 corporation, and no stock of the acquiring corporation is used
4 in the transaction; or

5 (viii) a transaction otherwise qualifying under subclause
6 (i) shall not be disqualified by reason of the fact that stock
7 of a corporation (referred to in this subclause as the
8 "controlling corporation") which before the merger was in
9 control of the merged corporation is used in the transaction, if
10 after the transaction, the corporation surviving the merger
11 holds substantially all of its properties and of the properties
12 of the merged corporation (other than stock of the controlling
13 corporation distributed in the transaction); and in the
14 transaction, former shareholders of the surviving corporation
15 exchanged, for an amount of voting stock of the controlling
16 corporation, an amount of stock in the surviving corporation
17 which constitutes control of such corporation.

18 For purposes of this clause, the term "control" means the
19 ownership of stock possessing at least eighty per cent of the
20 total combined voting power of all classes of stock entitled to
21 vote and at least eighty per cent of the total number of shares
22 of all other classes of stock of the corporation.

23 For purposes of this clause, the term "a party to a
24 reorganization" includes a corporation resulting from a
25 reorganization, and both corporations, in the case of a
26 reorganization resulting from the acquisition by one corporation
27 of stock or properties of another. In the case of a
28 reorganization qualifying under subclause (i) by reason of
29 subclause (vii) the term "a party to a reorganization" includes
30 the controlling corporation referred to in such subclause (vii).

1 Notwithstanding any provisions hereof, upon every such
2 exchange or conversion, the taxpayer's base for the stock or
3 securities received shall be the same as the taxpayer's actual
4 or attributed base for the stock, securities or property
5 surrendered in exchange therefor.

6 Except where a taxpayer's adjusted sales price of a former
7 qualifying ownership interest in a small business exceeds the
8 taxpayer's cost of purchasing the new qualifying ownership
9 interest in a small business, the term "net gains or income from
10 disposition of property" shall not include any gain derived from
11 the sale of a qualifying ownership interest in a small business,
12 if within a period 5 commencing two years before the date of the
13 sale and ending two years after the date, a qualifying ownership
14 in a new small business is purchased by the taxpayer.

15 For purposes of this act--

16 (i) an exchange by a taxpayer of a qualifying ownership
17 interest in a small business for another qualifying ownership
18 interest shall be treated as a sale of the interest and the
19 acquisition of a qualifying ownership interest in a small
20 business on the exchange of another qualifying business shall be
21 treated as a purchase of the interest;

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

29 (iii) the basis for determining the net gain or income shall
30 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

1 corporation. The term "small business" shall mean a business
2 enterprise operated by the corporation as its principal business
3 or a partnership, limited partnership, corporation, association
4 or other business entity in which the corporation holds a
5 qualifying ownership interest which, together with parents,
6 subsidiaries or affiliates employs in the aggregate less than
7 two hundred employees on an annual basis.

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

17 (c) For purposes of this section: (i) an exchange by the
18 corporation of a qualifying ownership interest in a small
19 business for another qualifying ownership interest shall be
20 treated as a sale of such interest and the acquisition of a
21 qualifying ownership interest in a small business on the
22 exchange of another qualifying interest shall be treated as a
23 purchase of such interest; (ii) no gain on the sale of a
24 qualifying ownership interest in a small business shall be
25 excluded from taxable income under this act if the new
26 qualifying ownership interest is purchased before the date of
27 sale of the old qualifying ownership interest and sold or
28 otherwise disposed of before the date of sale of the old
29 qualifying ownership interest; (iii) the basis for determining
30 the net gain on the disposition of a qualifying ownership

1 interest in a small business shall be the value of all
2 consideration paid in purchasing a qualifying ownership interest
3 less any gain not included in taxable income pursuant to the
4 provisions of this subclause in the immediately preceding sale
5 made which invoked these provisions.

6 Section 4. This act shall apply to taxable years beginning
7 on or after January 1, 1990.

8 Section 5. This act shall take effect immediately.