

Community Bank Flexibility Act (H.R. 3287)

Background and Purpose

The *Community Bank Flexibility Act* (H.R. 3287) would provide a much-needed choice to banks, especially small institutions serving local communities, to allow them to meet new capital demands with the freedom to organize as limited liability companies (LLCs) for tax purposes.

Approximately 90% of US banking organizations have under \$1 billion in assets and are thus widely classified as small. Many primarily serve the needs of local families and businesses. These institutions are a key part of our national economic engine.

Unfortunately, the climate of increasing regulation after the financial crisis of 2008 has put added burden on smaller institutions—a burden that is disproportionate to the risk they pose to the banking system. They need to meet new capital requirements and remain viable while being constrained, unlike other businesses, in the ways in which they can organize. Required to be corporations for tax purposes, banks either have to submit to the double-taxation of C corporations or the stringent limits on number and types of shareholders of S corporations.

The LLC form is established and widespread in many sectors of business. It provides the flexibility of optional pass-through tax treatment, with greater opportunity to raise capital without a limit on the number of members or their interest. Many community banks, uniquely working under capital requirements, could benefit from the LLC form but are obligated to be corporations under Depression-era rules that could not have predicted the existence of LLCs.

Banks, especially smaller institutions, require an opportunity to raise capital in new ways, without introducing new risks into the financial system, in order to thrive in the current climate and continue to provide everyday Americans with important financial services.

Legislative Solution

The *Community Bank Flexibility Act* would provide opportunities for banks to raise needed capital and be treated like other businesses, without diminishing soundness requirements, by:

- 1) Allowing banks to be organized as LLCs for tax purposes.
- 2) Providing a five-year window for existing banks to reorganize as LLCs without going through the prohibitive tax of a liquidation.
- 3) Preventing unfair use of the LLC election by putting a five-year built-in gains recognition period on C corporations reorganizing as LLCs, similar to those reorganizing as S corporations; and continuing that period for S corporations that reorganize as LLCs less than five years after having been C corporations.

In the current regulatory environment, many banks need the freedom to organize in alternative forms, as other businesses can, in order to meet their capital requirements, grow, and better serve their communities.

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(Original Signature of Member)

114TH CONGRESS
1ST SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to clarify the treatment of
banks organized as limited liability companies.

IN THE HOUSE OF REPRESENTATIVES

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

A BILL

To amend the Internal Revenue Code of 1986 to clarify
the treatment of banks organized as limited liability com-
panies.

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.**

4 This Act may be cited as the “Community Bank
5 Flexibility Act”.

1 **SEC. 2. TREATMENT OF BANKS ORGANIZED AS LIMITED LI-**
2 **ABILITY COMPANIES.**

3 (a) IN GENERAL.—Section 581 of the Internal Rev-
4 enue Code of 1986 is amended—

5 (1) by striking “For purposes of” and inserting
6 the following:

7 “(a) IN GENERAL.—For purposes of”, and

8 (2) by adding at the end the following new sub-
9 section:

10 “(b) TREATMENT OF LIMITED LIABILITY COMPA-
11 NIES, ETC.—

12 “(1) IN GENERAL.—An entity shall not fail to
13 be treated as a bank under subsection (a) merely be-
14 cause such entity is a specified entity (or because
15 such entity elects to be treated either as a corpora-
16 tion or as a partnership for purposes of this title).

17 “(2) SPECIFIED ENTITY.—For purposes of this
18 subsection, the term ‘specified entity’ means any en-
19 tity which may elect to be treated either as a cor-
20 poration or as a partnership for purposes of this
21 title.

22 “(3) TRANSITIONAL RULES.—

23 “(A) REORGANIZATIONS.—In the case of
24 any acquisition or transfer during the 5-year
25 period beginning on the date of the enactment
26 of this subsection, any specified entity which

1 (after such acquisition or transfer) qualifies as
2 a bank under paragraph (1) shall be treated as
3 a corporation for purposes of applying section
4 368(a)(1).

5 “(B) TAX IMPOSED ON CERTAIN BUILT-IN
6 GAINS.—

7 “(i) IN GENERAL.—In the case of any
8 specified entity with respect to which any
9 transfer or acquisition is treated as a reor-
10 ganization under section 368(a)(1) by rea-
11 son of this paragraph, rules similar to the
12 rules of section 1374 shall apply with re-
13 spect to such specified entity by treating
14 such reorganization in the same manner as
15 an election under section 1362(a) (and by
16 treating the specified entity as an S cor-
17 poration and the other corporation with re-
18 spect to such reorganization as the small
19 business corporation making such election).

20 “(ii) SPECIAL RULE FOR REORGA-
21 NIZATIONS DURING RECOGNITION PERIOD
22 OF AN S CORPORATION BANK.—In the case
23 of a transfer or acquisition to which clause
24 (i) applies, if—

1 “(I) the other corporation re-
2 ferred to in clause (i) is an S corpora-
3 tion, and

4 “(II) such transfer or acquisition
5 occurs during the recognition period
6 (as defined in section 1374(d)(7)) of
7 such S corporation,

8 the recognition period of the specified enti-
9 ty determined by reason of the application
10 of clause (i) shall not include any taxable
11 year of the specified entity which begins
12 after the recognition period of such S cor-
13 poration.

14 “(C) ELECTION TO HAVE TRANSITION
15 RULES NOT APPLY.—Subparagraphs (A) and
16 (B) shall not apply if the specified entity re-
17 ferred to in such subparagraphs elects under
18 this subparagraph to have such subparagraphs
19 not apply. Any such election shall, except as
20 otherwise provided by the Secretary, be made
21 contemporaneously with the acquisition or
22 transfer referred to in subparagraph (A).”.

23 (b) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to taxable years beginning after
25 the date of the enactment of this Act.