

SEC. 3. Section 542(e)(8) of the Internal Revenue Code of 1954 (relating to exemption of small business investment companies from the definition of a personal holding company) is amended to read as follows:

"(8) A small business investment company which is licensed by the Small Business Administration and operating under the Small Business Investment Act of 1958, as amended, and which is actively engaged in the business of providing funds to small business concerns under that Act. This paragraph shall not apply if the small business investment company fails to meet restrictions on control of small business concerns by small business investment companies or on conflicts of interest involving the small business investment company, its shareholders and small business concerns financed by the small business investment company, set forth in regulations jointly promulgated by the Administrator of the Small Business Administration and the Secretary or his delegate."

SEC. 4. Section 851 of the Internal Revenue Code (relating to the definition of regulated investment company) is amended by inserting after subsection (e) the following new subsection:

"(f) SPECIAL RULE FOR SMALL BUSINESS INVESTMENT COMPANIES.—

"(1) GENERAL RULE.—Notwithstanding subsection (b)(4) of this section a small business investment company operating under the Small Business Investment Act of 1958, as amended, may be considered a regulated investment company for any taxable year if, at the close of the taxable year—

"(A) at least 50 percent of the value of its total assets is represented by—

"(i) cash and cash items (including receivables), Government securities and securities of other regulated investment companies, and

"(ii) other securities for purpose of this calculation limited in respect of any one issuer to an amount not greater in value than 20 percent of the amount of combined paid-in capital and paid-in surplus of the small business investment company and to not more than 50 percent of the outstanding voting securities of such issuer, and

"(B) not more than 25 percent of the value of its total assets is invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary or his delegate, to be engaged in the same or similar trades or businesses or related trades or businesses.

"(2) TEN-YEAR LIMITATION.—

"(A) Securities of an issuer in which the small business investment company has continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed by the Secretary or his delegate) for 10 or more years may not be taken into account for the purpose of subparagraph (A)(ii) of paragraph (1) unless such securities are limited in respect of any such issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer.

"(B) Section 851(d) shall not apply in determining whether a small business investment company qualifies as a regulated investment company for any taxable year if at the close of such year it owns securities of an issuer in which such small business investment company has continuously held any security of such issuer (or any predecessor of such issuer as determined under regulations prescribed by the Secretary or his delegate) for 10 or more years and such small business investment company would not have qualified as a regulated investment company for any prior taxable year unless securities of such issuer were taken into account under subparagraph (A)(ii) of this section.

"(3) APPLICABLE RULES.—For purposes of this subsection—

"(A) Section 851(c) shall apply except that in the case of securities of an issuer in which the small business investment company has not continuously held any security of such issuer (or of any predecessor company of such issuer as determined under regulations prescribed