

small business investment company of stock acquired by such company pursuant to the Small Business Investment Act of 1958, as amended, and in accordance with regulations of the Small Business Administration prescribed under such Act, the basis of such stock shall be reduced (but not below zero) by an amount equal to the amount of any distribution received by such company with respect to such stock on or after the date of the enactment of this subsection, to the extent that any such distribution is made by the distributing corporation out of its earnings and profits accumulated prior to the date of the acquisition of such stock by the small business investment company.

“(e) GAIN OR LOSS FROM DEBT.—

“(1) GENERAL RULE.—A debt acquired pursuant to the Small Business Investment Act of 1958, as amended, and in accordance with the regulations of the Small Business Administration prescribed under such Act, shall not be treated as a capital asset, whether or not it is evidenced by a security defined in section 165(g)(2)(C).

“(2) SPECIAL RULE FOR CONVERTIBLE DEBENTURES.—

“(A) DETERMINATION OF COST.—For purposes of this section and section 16(h), in determining the cost of a convertible debenture, amounts paid to acquire the debenture shall be allocated first to the debt to the extent of the redemption price at maturity, and thereafter to the conversion privilege. In the sale or exchange of a convertible debenture, amounts received in excess of the redemption price at maturity shall be treated as received in exchange for the conversion privilege.

“(B) COMPUTATION OF RESERVE FOR BAD DEBTS.—If the taxpayer exercises the conversion privilege of a debenture during the taxable year, the amount by which the reserve for bad debts which is allowable to the taxpayer under subsections (c) and (h) of section 166 is reduced by reason of such exercise shall be included in the taxpayer's gross income for such taxable year, but only to the extent that the actual reserve for bad debts at the end of the taxable year exceeds the allowable reserve for bad debts at the end of such taxable year.

“(f) DEFINITION OF EQUITY SECURITIES.—For purposes of this section, the term ‘equity securities’ means—

“(1) stock of any class of type;

“(2) any option or conversion or exchange privilege issued and/or acquired in connection with the purchase of any stock, convertible debenture, or debt instrument; or

“(3) any combination of the foregoing.”

SEC. 7. (a) The amendments made by sections 2, 4, and 6 shall apply to taxable years beginning on or after April 1, 1968.

(b) The amendments made by section 3 shall apply to taxable years beginning on or after the date on which regulations contemplated by section 3 are promulgated.

(c) The amendments made by section 5 shall apply to taxable years ending after the date of the enactment of this Act.

I. SUMMARY OF H.R. 10410, SBIC TAX BILL

SECTION-BY-SECTION ANALYSIS OF THE BILL

The bill would amend the Internal Revenue Code with respect to the tax treatment of small business investment companies (SBICs), in order to aid such companies in carrying out the purposes of the Small Business Investment Act of 1958. Experience under the SBIC program has shown that these tax amendments are necessary to correct certain problems and deficiencies which have become apparent in present law. The bill is thus an important element in the legislative program which has been developed to improve the industry through providing for larger and more effective SBICs, attracting investment in them, and encouraging them to engage in more equity-type financing of small concerns.

BACKGROUND OF THE LEGISLATIVE PROGRAM

The central purpose of the Small Business Investment Act is, by means of private SBICs, to assist small concerns in obtaining high risk venture capital not readily available from normal financing sources. Congress found clear evidence of the need for such an institution when it established the program in 1958, and