

105TH CONGRESS  
1ST SESSION

# H. R. 1207

To amend the Internal Revenue Code of 1986 to provide all taxpayers with a 50 percent deduction for capital gains, to increase the exclusion for gain on qualified small business stock, to index the basis of certain capital assets, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

MARCH 20, 1997

Mr. WATKINS introduced the following bill; which was referred to the  
Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to provide all taxpayers with a 50 percent deduction for capital gains, to increase the exclusion for gain on qualified small business stock, to index the basis of certain capital assets, and for other purposes.

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 “Economic Competitive-  
5       ness and Growth Act”.

1 **SEC. 2. 50 PERCENT CAPITAL GAINS DEDUCTION.**

2 (a) GENERAL RULE.—Section 1201 of the Internal  
3 Revenue Code of 1986 is amended to read as follows:

4 **“SEC. 1201. CAPITAL GAINS DEDUCTION.**

5 “(a) GENERAL RULE.—If for any taxable year a tax-  
6 payer has a net capital gain, 50 percent of such gain shall  
7 be a deduction from gross income.

8 “(b) ESTATES AND TRUSTS.—In the case of an es-  
9 tate or trust, the deduction shall be computed by excluding  
10 the portion (if any) of the gains for the taxable year from  
11 sales or exchanges of capital assets which, under sections  
12 652 and 662 (relating to inclusions of amounts in gross  
13 income of beneficiaries of trusts), is includible by the in-  
14 come beneficiaries as gain derived from the sale or ex-  
15 change of capital assets.

16 “(c) COORDINATION WITH TREATMENT OF CAPITAL  
17 GAIN UNDER LIMITATION ON INVESTMENT INTEREST.—  
18 For purposes of this section, the net capital gain for any  
19 taxable year shall be reduced (but not below zero) by the  
20 amount which the taxpayer takes into account as invest-  
21 ment income under section 163(d)(4)(B)(iii).

22 “(d) TRANSITIONAL RULES.—

23 “(1) IN GENERAL.—In the case of a taxable  
24 year which includes January 1, 1997—

25 “(A) the amount taken into account as the  
26 net capital gain under subsection (a) shall not

1 exceed the net capital gain determined by only  
2 taking into account gains and losses properly  
3 taken into account for the portion of the tax-  
4 able year on or after January 1, 1997, and

5 “(B) the amount of the net capital gain  
6 taken into account in applying section 1(h) for  
7 such year shall be reduced by the amount taken  
8 into account under subparagraph (A) for such  
9 year.

10 “(2) SPECIAL RULES FOR PASS-THROUGH ENTI-  
11 TIES.—

12 “(A) IN GENERAL.—In applying paragraph  
13 (1) with respect to any pass-through entity, the  
14 determination of when gains and losses are  
15 properly taken into account shall be made at  
16 the entity level.

17 “(B) PASS-THROUGH ENTITY DEFINED.—  
18 For purposes of subparagraph (A), the term  
19 ‘pass through entity’ means—

20 “(i) a regulated investment company,

21 “(ii) a real estate investment trust,

22 “(iii) an S corporation,

23 “(iv) a partnership,

24 “(v) an estate or trust, and

25 “(vi) a common trust fund.”

1       (b) DEDUCTION ALLOWABLE IN COMPUTING AD-  
2 JUSTED GROSS INCOME.—Subsection (a) of section 62 of  
3 such Code is amended by inserting after paragraph (16)  
4 the following new paragraph:

5           “(17) LONG-TERM CAPITAL GAINS.—The de-  
6 duction allowed by section 1201.”

7       (c) TECHNICAL AND CONFORMING CHANGES.—

8           (1) Section 1 of such Code is amended by strik-  
9 ing subsection (h).

10          (2) Section 12 of such Code is amended by  
11 striking paragraph (4) and redesignating the follow-  
12 ing paragraphs accordingly.

13          (3)(A) Subsection (a) of section 57 of such  
14 Code is amended by striking paragraph (7).

15          (B) Subclause (II) of section 53(d)(1)(B)(ii) of  
16 such Code is amended by striking “, (5), and (7)”  
17 and inserting “and (5)”.

18          (4) Paragraph (1) of section 170(e) of such  
19 Code is amended by striking “the amount of gain”  
20 in the material following subparagraph (B)(ii) and  
21 inserting “50 percent of the amount of gain”.

22          (5) Paragraph (2) of section 172(d) of such  
23 Code is amended to read as follows:

24           “(2) CAPITAL GAINS AND LOSSES.—

1           “(A) LOSSES OF TAXPAYERS OTHER THAN  
2           CORPORATIONS.—In the case of a taxpayer  
3           other than a corporation, the amount deductible  
4           on account of losses from sales or exchanges of  
5           capital assets shall not exceed the amount in-  
6           cludible on account of gains from sales or ex-  
7           changes of capital assets.

8           “(B) DEDUCTION FOR CAPITAL GAINS.—  
9           The deduction under section 1201 shall not be  
10          allowed.”

11          (6) The last sentence of section 433A(c)(3) of  
12          such Code is amended by striking all that follows  
13          “long-term capital gain,” and inserting “the deduc-  
14          tion under section 1201 shall be taken into ac-  
15          count.”

16          (7) Paragraph (2) of section 468B(b) of such  
17          Code is amended by inserting “the deduction allowed  
18          by section 1201 and by” after “reduced by”.

19          (8) Paragraph (2) of section 527(b) of such  
20          Code is hereby repealed.

21          (9) Subparagraph (A) of section 641(d)(2) of  
22          such Code is amended by striking “Except as pro-  
23          vided in section 1(h), the” and inserting “The”.

24          (10) Paragraph (4) of section 642(c) of such  
25          Code is amended to read as follows:

1           “(4) ADJUSTMENTS.—To the extent that the  
2           amount otherwise allowable as a deduction under  
3           this subsection consists of gain from the sale or ex-  
4           change of capital assets held for more than 1 year,  
5           proper adjustment shall be made for any deduction  
6           allowable to the estate or trust under section 1201  
7           (relating to capital gains deduction). In the case of  
8           a trust, the deduction allowed by this subsection  
9           shall be subject to section 681 (relating to unrelated  
10          business income).”

11          (11) The last sentence of section 643(a)(3) of  
12          such Code is amended to read as follows: “The de-  
13          duction under section 1201 (relating to capital gains  
14          deduction) shall not be taken into account.”

15          (12) Subparagraph (C) of section 643(a)(6) of  
16          such Code is amended by inserting “(i)” before  
17          “there shall” and by inserting before the period “,  
18          and (ii) the deduction under section 1201 (relating  
19          to capital gains deduction) shall not be taken into  
20          account.”

21          (13) Paragraph (4) of section 691(c) of such  
22          Code is amended by striking “1(h),”.

23          (14) Paragraph (2) of section 801(a) of such  
24          Code is hereby repealed.

1           (15) Subsection (c) of section 831 of such Code  
2           is amended by striking paragraph (1) and redesignig-  
3           nating the following paragraphs accordingly.

4           (16)(A) Subparagraph (A) of section 852(b)(3)  
5           of such Code is amended by striking “, determined  
6           as provided in section 1201(a), on” and inserting  
7           “of 17.5 percent of”.

8           (B) Clause (iii) of section 852(b)(3)(D) of such  
9           Code is amended—

10           (i) by striking “65 percent” and inserting  
11           “82.5 percent”, and

12           (ii) by striking “section 1201(a)” and in-  
13           serting “subparagraph (A)”.

14           (17) Clause (ii) of section 857(b)(3)(A) of such  
15           Code is amended by striking “determined at the rate  
16           provided in section 1201(a) on “and inserting” of  
17           17.5 percent of”.

18           (18) The second sentence of section 871(a)(2)  
19           of such Code is amended by striking “1202” and in-  
20           serting “1201”.

21           (19) Paragraph (1) of section 882(a) of such  
22           Code is amended by striking “section 11,55,5A, or  
23           1201(a)” and inserting “section 11,55, or 59A”.

24           (20)(A) Paragraph (2) of section 904(b) of  
25           such Code is amended to read as follows:

1           “(2) CAPITAL GAINS.—Taxable income from  
2           sources outside the United States shall include gain  
3           from the sale or exchange of capital assets only to  
4           the extent of foreign source capital gain net in-  
5           come.”

6           (B) Paragraph (3) of section 904(b) of such  
7           Code is amended by striking subparagraphs (B),  
8           (D), and (E) and by redesignating subparagraph (C)  
9           as subparagraph (B).

10          (21)(A) Paragraph (2) of section 1211(b) of  
11          such Code is amended to read as follows:

12               “(2) the sum of—

13                       “(A) the excess of the net short-term cap-  
14                       ital loss over the net long-term capital gain, and

15                       “(B) one-half of the excess of the net long-  
16                       term capital loss over the net short-term capital  
17                       gain.”

18          (B) So much of paragraph (2) of section  
19          1212(b) of such Code as precedes subparagraph (B)  
20          thereof is amended to read as follow:

21               “(2) SPECIAL RULES.—

22                       “(A) ADJUSTMENTS.—

23                               “(i) For purposes of determining the  
24                               excess referred to in paragraph (1)(A),  
25                               there shall be treated as short-term capital



1 gain in the taxable year an amount equal  
2 to the lesser of—

3 “(I) the amount allowed for the  
4 taxable year under paragraph (1) or  
5 (2) of section 1211(b), or

6 “(II) the adjusted taxable income  
7 for such taxable year.

8 “(ii) For purposes of determining the  
9 excess referred to in paragraph (1)(B),  
10 there shall be treated as short-term capital  
11 gain in the taxable year an amount equal  
12 to the sum of—

13 “(I) the amount allowed for the  
14 taxable year under paragraph (1) or  
15 (2) of section 1211(b) or the adjusted  
16 taxable income for such taxable year,  
17 whichever is the least, plus.

18 “(II) the excess of the amount  
19 described in subclause (I) over the net  
20 short-term capital loss (determined  
21 without regard to this subsection) for  
22 such year.”

23 (C) Subsection (b) of section 1212 is amended  
24 by adding at the end the following new paragraph:

25 “(3) TRANSITIONAL RULE.—

“(A) IN GENERAL.—The amount determined under subclause (II) of paragraph (2)(A)(ii) for any taxable year shall be reduced (but not below zero) by the excess of—

“(i) the amount of the unused pre-1998 long-term capital loss for such year, over

“(ii) the sum of the long-term capital gain and the net short-term capital gain for such taxable year.

Section 1211(b)(2)(B) shall be applied without regard to “one-half of” with respect to such excess for such taxable year.

“(B) UNUSED PRE-1998 LONG-TERM CAPITAL LOSS—For purposes of this paragraph, the term “unused pre-1998 long-term capital loss” means, with respect to a taxable year, the excess of—

“(i) the amount which under paragraph (1)(B) (as in effect for taxable years beginning before January 1, 1998) is treated as a long-term capital loss for the taxpayer’s first taxable year beginning after December 31, 1997, over

“(ii) the sum of—

1                   “(I) the aggregate amount deter-  
2                   mined under subparagraph (A)(ii) for  
3                   all prior taxable years beginning after  
4                   December 31, 1997, and

5                   “(II) the aggregate reductions  
6                   under subparagraph (A) for all such  
7                   prior taxable years.”

8                   (22) Subsection (b) of section 1374 of such  
9                   Code is amended by striking paragraph (4).

10                  (23) Subsection (b) of section 1381 is amended  
11                  by striking “or 1201”.

12                  (24) Paragraph (1) of section 1402(i) of such  
13                  Code is amended by inserting “, and the deduction  
14                  provided by section 1201 shall not apply” before the  
15                  period at the end thereof.

16                  (25) Subsection (e) of section 1445 of such  
17                  Code is amended—

18                         (A) in paragraph (1) by striking “35 per-  
19                         cent (or, to the extent provided in regulations,  
20                         28 percent)” and inserting “17.5 percent (or, to  
21                         the extent provided in regulations, 19.8 per-  
22                         cent)”, and

23                         (B) in paragraph (2) by striking “35 per-  
24                         cent” and inserting “17.5 percent”.

1           (26) Clause (i) of section 6425(c)(1)(A) of such  
2 Code is amended by striking “or 1201(a)”.

3           (27) Clause (i) of section 6655(g)(1)(A) of such  
4 Code is amended by striking “or 1201(a)”.

5           (28)(A) The second sentence of section  
6 7518(g)(6)(A) of such Code is amended—

7                 (i) by striking “during a taxable year to  
8 which section 1(h) or 1201(a) applies”, and

9                 (ii) by striking “28 percent (34 percent”  
10 and inserting “19.8 percent (17.5 percent”.

11           (B) The second sentence of section  
12 607(h)(6)(A) of the Merchant Marine Act, 1936 is  
13 amended—

14                 (i) by striking “during a taxable year to  
15 which section 1(h) or 1201(a) of such Code ap-  
16 plies”, and

17                 (ii) by striking “28 percent (34 percent”  
18 and inserting “19.8 percent (17.5 percent”.

19           (29) The table of sections for part I of sub-  
20 chapter P of chapter 1 of such Code is amended by  
21 striking the item relating to section 1201 and insert-  
22 ing the following:

“Sec. 1201. Capital gains deduction.”

23           (d) EFFECTIVE DATES.—

24                 (1) IN GENERAL.—Except as otherwise pro-  
25 vided in this subsection, the amendments made by

1       this section apply to taxable years ending after De-  
2       cember 31, 1996.

3           (2) REPEAL OF SECTION 1(h).—The amend-  
4       ment made by subsection (c)(1) shall apply to tax-  
5       able years beginning after January 1, 1997.

6           (3) CONTRIBUTIONS.—The amendment made  
7       by subsection (c)(4) shall apply only to contributions  
8       on or after January 1, 1997.

9           (4) USE OF LONG-TERM LOSSES.—The amend-  
10      ments made by subsection (c)(21) shall apply to tax-  
11      able years beginning after December 31, 1997.

12          (5) WITHHOLDING.—The amendment made by  
13      subsection (c)(25) shall apply only to amounts paid  
14      after the date of the enactment of this Act.

15          (6) COORDINATION WITH PRIOR TRANSITION  
16      RULE.—Any amount treated as long-term capital  
17      gain by reason of paragraph (3) of section 1122(h)  
18      of the Tax Reform Act of 1986 shall not be taken  
19      into account for purposes of applying section 1201  
20      of the Internal Revenue Code of 1986 (as added by  
21      this section).

22   **SEC. 3. INCREASED EXCLUSION AND OTHER MODIFICA-**  
23                   **TIONS APPLICABLE TO QUALIFIED SMALL**  
24                   **BUSINESS STOCK.**

25          (a) INCREASED EXCLUSION.—

1           (1) IN GENERAL.—Subsection (a) of section  
2       1202 of the Internal Revenue Code of 1986 (50-per-  
3       cent exclusion for gain from certain small business  
4       stock) is amended—

5                   (A) by striking “50 percent” and inserting  
6       “75 percent”, and

7                   (B) by striking “50-Percent” in the head-  
8       ing and inserting “75-Percent”.

9       (2) CONFORMING AMENDMENTS.—

10                   (A) The heading for section 1202 of such  
11       Code is amended by striking “50-percent” and  
12       inserting “75-percent”.

13                   (B) The table of sections for part I of sub-  
14       chapter P of chapter 1 of such Code is amended  
15       by striking “50-percent” in the item relating to  
16       section 1202 and inserting “75-percent”.

17       (b) REDUCTION IN HOLDING PERIOD.—Subsection  
18   (a) of section 1202 of such Code is amended by striking  
19   “5 years” and inserting “3 years”.

20       (c) EXCLUSION AVAILABLE TO CORPORATIONS.—

21                   (1) IN GENERAL.—Subsection (a) of section  
22       1202 of such Code is amended by striking “other  
23       than a corporation”.

1           (2) TECHNICAL AMENDMENT.—Subsection (c)  
 2           of section 1202 of such Code is amended by adding  
 3           at the end the following new paragraph:

4           “(4) STOCK HELD AMONG MEMBERS OF CON-  
 5           TROLLED GROUP NOT ELIGIBLE.—Stock of a mem-  
 6           ber of a parent-subsidiary controlled group (as de-  
 7           fined in subsection (d)(3)) shall not be treated as  
 8           qualified small business stock while held by another  
 9           member of such group.”

10          (d) REPEAL OF MINIMUM TAX PREFERENCE.—

11           (1) IN GENERAL.—Subsection (a) of section 57  
 12           of such Code (relating to items of tax preference) is  
 13           amended by striking paragraph (7).

14           (2) TECHNICAL AMENDMENT.—Subclause (II)  
 15           of section 53(d)(1)(B)(ii) of such Code is amended  
 16           by striking “, (5), and (7)” and inserting “and (5)”.

17          (e) STOCK OF LARGER BUSINESSES ELIGIBLE FOR  
 18          EXCLUSION.—

19           (1) IN GENERAL.—Paragraph (1) of section  
 20           1202(d) of such Code (defining qualified small busi-  
 21           ness) is amended by striking “\$50,000,000” each  
 22           place it appears and inserting “\$100,000,000”.

23           (2) INFLATION ADJUSTMENT.—Section 1202(d)  
 24           of such Code is amended by adding at the end the  
 25           following:

1           “(4) INFLATION ADJUSTMENT OF ASSET LIM-  
 2           TATION.—In the case of stock issued in any calendar  
 3           year after 1998, the \$100,000,000 amount con-  
 4           tained in paragraph (1) shall be increased by an  
 5           amount equal to—

6                     “(A) such dollar amount, multiplied by

7                     “(B) the cost-of-living adjustment deter-  
 8                     mined under section 1(f)(3) for the calendar  
 9                     year in which the taxable year begins, deter-  
 10                    mined by substituting ‘calendar year 1997’ for  
 11                    ‘calendar year 1992’ in subparagraph (B)  
 12                    thereof.

13           If any amount as adjusted under the preceding sen-  
 14           tence is not a multiple of \$10,000, such amount  
 15           shall be rounded to the nearest multiple of  
 16           \$10,000.”

17           (f) REPEAL OF PER-ISSUER LIMITATION.—Section  
 18   1202 of such Code is amended by striking subsection (b).

19           (g) OTHER MODIFICATIONS.—

20                   (1) REPEAL OF WORKING CAPITAL LIMITA-  
 21           TION.—Section 1202(e)(6) of such Code (relating to  
 22           working capital) is amended—

23                           (A) in subparagraph (B), by striking “2  
 24                           years” and inserting “5 years”, and

25                           (B) by striking the last sentence.



1           (2) EXCEPTION FROM REDEMPTION RULES  
2       WHERE BUSINESS PURPOSE.—Section 1202(c)(3) of  
3       such Code (relating to certain purchases by corpora-  
4       tion of its own stock) is amended by adding at the  
5       end the following:

6                   “(D) WAIVER WHERE BUSINESS PUR-  
7                   POSE.—A purchase of stock by the issuing cor-  
8                   poration shall be disregarded for purposes of  
9                   subparagraph (B) if the issuing corporation es-  
10                  tablishes that there was a business purpose for  
11                  such purchase and one of the principal purposes  
12                  of the purchase was not to avoid the limitations  
13                  of this section.”

14       (h) QUALIFIED TRADE OR BUSINESS.—Section  
15       1202(e)(3) of such Code (defining qualified trade or busi-  
16       ness) is amended by inserting “and” at the end of sub-  
17       paragraph (C), by striking “, and” at the end of subpara-  
18       graph (D) and inserting a period, and by striking subpara-  
19       graph (E).

20       (i) EFFECTIVE DATES.—

21           (1) IN GENERAL.—Except as provided in para-  
22       graph (2), the amendments made by this section  
23       apply to stock issued after the date of enactment of  
24       this Act.

1           (2) SPECIAL RULE.—The amendments made by  
2       subsections (a), (c), (e), and (f) apply to stock is-  
3       sued after August 10, 1993.

4   **SEC. 4. ROLLOVER OF GAIN FROM SALE OF QUALIFIED**  
5               **STOCK.**

6       (a) IN GENERAL.—Part III of subchapter O of chap-  
7   ter 1 of the Internal Revenue Code of 1986 (relating to  
8   common nontaxable exchanges) is amended by adding at  
9   the end the following:

10   **“SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL**  
11               **BUSINESS STOCK TO ANOTHER QUALIFIED**  
12               **SMALL BUSINESS STOCK.**

13       “(a) NONRECOGNITION OF GAIN.—In the case of any  
14   sale of qualified small business stock with respect to which  
15   the taxpayer elects the application of this section, eligible  
16   gain from such sale shall be recognized only to the extent  
17   that the amount realized on such sale exceeds—

18           “(1) the cost of any qualified small business  
19       stock purchased by the taxpayer during the 60-day  
20       period beginning on the date of such sale, reduced  
21       by

22           “(2) any portion of such cost previously taken  
23       into account under this section.

24   This section shall not apply to any gain which is treated  
25   as ordinary income for purposes of this title.

1       “(b) DEFINITIONS AND SPECIAL RULES.—For pur-  
2 poses of this section—

3               “(1) QUALIFIED SMALL BUSINESS STOCK.—The  
4 term ‘qualified small business stock’ has the mean-  
5 ing given such term by section 1202(c).

6               “(2) ELIGIBLE GAIN.—The term ‘eligible gain’  
7 means any gain from the sale or exchange of quali-  
8 fied small business stock held for more than 6  
9 months.

10              “(3) PURCHASE.—A taxpayer shall be treated  
11 as having purchased any property if, but for para-  
12 graph (4), the unadjusted basis of such property in  
13 the hands of the taxpayer would be its cost (within  
14 the meaning of section 1012).

15              “(4) BASIS ADJUSTMENTS.—If gain from any  
16 sale is not recognized by reason of subsection (a),  
17 such gain shall be applied to reduce (in the order ac-  
18 quired) the basis for determining gain or loss of any  
19 qualified small business stock which is purchased by  
20 the taxpayer during the 60-day period described in  
21 subsection (a).

22       “(c) SPECIAL RULES FOR TREATMENT OF REPLACE-  
23 MENT STOCK.—

24              “(1) HOLDING PERIOD FOR ACCRUED GAIN.—  
25 For purposes of this chapter, gain from the disposi-

tion of any replacement qualified small business stock shall be treated as gain from the sale or exchange of qualified small business stock held more than 6 months to the extent that the amount of such gain does not exceed the amount of the reduction in the basis of such stock by reason of subsection (b)(4).

“(2) TACKING OF HOLDING PERIOD FOR PURPOSES OF DEFERRAL.—Solely for purposes of applying this section, if any replacement qualified small business stock is disposed of before the taxpayer has held such stock for more than 6 months, gain from such stock shall be treated eligible gain for purposes of subsection (a).

“(3) REPLACEMENT QUALIFIED SMALL BUSINESS STOCK.—For purposes of this subsection, the term ‘replacement qualified small business stock’ means any qualified small business stock the basis of which was reduced under subsection (b)(4).”

(b) CONFORMING AMENDMENTS.—

(1) Section 1016(a)(23) of such Code is amended—

(A) by striking “or 1044” and inserting “, 1044, or 1045”; and

1 (B) by striking “or 1044(d)” and inserting  
 2 “, 1044(d), or 1045(b)(4)”.

3 (2) The table of sections for part III of sub-  
 4 chapter O of chapter 1 of such Code is amended by  
 5 adding at the end the following:

“Sec. 1045. Rollover of gain from qualified small business stock  
 to another qualified small business stock.”

6 (c) EFFECTIVE DATE.—The amendments made by  
 7 this section apply to stock sold or exchanged after the date  
 8 of the enactment of this Act.

9 **SEC. 5. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER**  
 10 **DECEMBER 31, 1996, FOR PURPOSES OF DE-**  
 11 **TERMINING GAIN OR LOSS.**

12 (a) IN GENERAL.—Part II of subpart O of chapter  
 13 1 of the Internal Revenue Code of 1986 (relating to basis  
 14 rules of general application) is amended by inserting after  
 15 section 1021 the following new section:

16 **“SEC. 1022. INDEXING OF CERTAIN ASSETS ACQUIRED**  
 17 **AFTER DECEMBER 31, 1996, FOR PURPOSES**  
 18 **OF DETERMINING GAIN OR LOSS.**

19 “(a) GENERAL RULE.—

20 “(1) INDEXED BASIS SUBSTITUTED FOR AD-  
 21 JUSTED BASIS.—Except as otherwise provided in  
 22 this subsection, if an indexed asset which has been  
 23 held for more than 3 years is sold or otherwise dis-  
 24 posed of, for purposes of this title the indexed basis

1 of the asset shall be substituted for its adjusted  
2 basis.

3 “(2) EXCEPT FOR DEPRECIATION, ETC.—The  
4 deductions for depreciation, depletion, and amortiza-  
5 tion shall be determined without regard to the appli-  
6 cation of paragraph (1) to the taxpayer or any other  
7 person.

8 “(b) INDEXED ASSET.—

9 “(1) IN GENERAL.—For purposes of this sec-  
10 tion, the term ‘indexed asset’ means—

11 “(A) common stock in a C corporation  
12 (other than a foreign corporation), and

13 “(B) tangible property,  
14 which is a capital asset or property used in the trade  
15 or business (as defined in section 1231(b)).

16 “(2) STOCK IN CERTAIN FOREIGN CORPORA-  
17 TIONS INCLUDED.—For purposes of this section—

18 “(A) IN GENERAL.—The term ‘indexed  
19 asset’ includes common stock in a foreign cor-  
20 poration which is regularly traded on an estab-  
21 lished securities market.

22 “(B) EXCEPTION.—Subparagraph (A)  
23 shall not apply to—

1 “(i) stock of a foreign investment  
2 company (within the meaning of section  
3 1246(b)),

4 “(ii) stock in a passive foreign invest-  
5 ment company (as defined in section  
6 1296),

7 “(iii) stock in a foreign corporation  
8 held by a United States person who meets  
9 the requirements of section 1248(a)(2),  
10 and

11 “(iv) stock in a foreign personal hold-  
12 ing company (as defined in section 552).

13 “(C) TREATMENT OF AMERICAN DEPOSI-  
14 TORY RECEIPTS.—An American depository re-  
15 ceipt for common stock in a foreign corporation  
16 shall be treated as common stock in such cor-  
17 poration.

18 “(c) INDEXED BASIS.—For purposes of this sec-  
19 tion—

20 “(1) GENERAL RULE.—The indexed basis for  
21 any asset is—

22 “(A) the adjusted basis of the asset, in-  
23 creased by

24 “(B) the applicable inflation adjustment.

1           “(2) APPLICABLE INFLATION ADJUSTMENT.—

2           The applicable inflation adjustment for any asset is  
3           an amount equal to—

4                   “(A) the adjusted basis of the asset, multi-  
5           plied by

6                   “(B) the percentage (if any) by which—

7                           “(i) the gross domestic product  
8                           deflator for the last calendar quarter end-  
9                           ing before the asset is disposed of, exceeds

10                           “(ii) the gross domestic product  
11                           deflator for the last calendar quarter end-  
12                           ing before the asset was acquired by the  
13                           taxpayer.

14           The percentage under subparagraph (B) shall  
15           be rounded to the nearest one-tenth of 1 per-  
16           centage point.

17           “(3) GROSS DOMESTIC PRODUCT DEFLATOR.—

18           The gross domestic product deflator for any cal-  
19           endar quarter is the implicit price deflator for the  
20           gross domestic product for such quarter (as shown  
21           in the last revision thereof released by the Secretary  
22           of Commerce before the close of the following cal-  
23           endar quarter).



1       “(d) SUSPENSION OF HOLDING PERIOD WHERE DI-  
2 MINISHED RISK OF LOSS; TREATMENT OF SHORT  
3 SALES.—

4           “(1) IN GENERAL.—If the taxpayer (or a relat-  
5 ed person) enters into any transaction which sub-  
6 stantially reduces the risk of loss from holding any  
7 asset, such asset shall not be treated as an indexed  
8 asset for the period of such reduced risk.

9           “(2) SHORT SALES.—

10           “(A) IN GENERAL.—In the case of a short  
11 sale of an indexed asset with a short sale period  
12 in excess of 3 years, for purposes of this title,  
13 the amount realized shall be an amount equal  
14 to the amount realized (determined without re-  
15 gard to this paragraph) increased by the appli-  
16 cable inflation adjustment. In applying sub-  
17 section (c)(2) for purposes of the preceding sen-  
18 tence, the date on which the property is sold  
19 short shall be treated as the date of acquisition  
20 and the closing date for the sale shall be treat-  
21 ed as the date of disposition.

22           “(B) SHORT SALE PERIOD.—For purposes  
23 of subparagraph (A), the short sale period be-  
24 gins on the day that the property is sold and  
25 ends on the closing date for the sale.

1       “(e) TREATMENT OF REGULATED INVESTMENT  
2 COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

3               “(1) ADJUSTMENT AT ENTITY LEVEL.—

4                       “(A) IN GENERAL.—Except as provided in  
5 subparagraph (B), the adjustment under sub-  
6 section (a) shall be allowed to any qualified in-  
7 vestment entity (including for purposes of de-  
8 termining the earnings and profits of such en-  
9 tity).

10                      “(B) EXCEPTION FOR QUALIFICATION  
11 PURPOSES.—This section shall not apply for  
12 purposes of sections 851(b) and 856(c).

13               “(2) ADJUSTMENTS TO INTERESTS HELD IN  
14 ENTITY.—

15                      “(A) REGULATED INVESTMENT COMPA-  
16 NIES.—Stock in a regulated investment com-  
17 pany (within the meaning of section 851) shall  
18 be an indexed asset for any calendar quarter in  
19 the same ratio as—

20                               “(i) the average of the fair market  
21 values of the indexed assets held by such  
22 company at the close of each month during  
23 such quarter, bears to

1                   “(ii) the average of the fair market  
2                   values of all assets held by such company  
3                   at the close of each such month.

4                   “(B)     REAL     ESTATE     INVESTMENT  
5                   TRUSTS.—Stock in a real estate investment  
6                   trust (within the meaning of section 856) shall  
7                   be an indexed asset for any calendar quarter in  
8                   the same ratio as—

9                   “(i) the fair market value of the in-  
10                  dexed assets held by such trust at the close  
11                  of such quarter, bears to

12                  “(ii) the fair market value of all as-  
13                  sets held by such trust at the close of such  
14                  quarter.

15                  “(C) RATIO OF 80 PERCENT OR MORE.—If  
16                  the ratio for any calendar quarter determined  
17                  under subparagraph (A) or (B) would (but for  
18                  this subparagraph) be 80 percent or more, such  
19                  ratio for such quarter shall be 100 percent.

20                  “(D) RATIO OF 20 PERCENT OR LESS.—If  
21                  the ratio for any calendar quarter determined  
22                  under subparagraph (A) or (B) would (but for  
23                  this subparagraph) be 20 percent or less, such  
24                  ratio for such quarter shall be zero.

1           “(E) LOOK-THROUGH OF PARTNER-  
 2           SHIPS.—For purposes of this paragraph, a  
 3           qualified investment entity which holds a part-  
 4           nership interest shall be treated (in lieu of hold-  
 5           ing a partnership interest) as holding its pro-  
 6           portionate share of the assets held by the part-  
 7           nership.

8           “(3) TREATMENT OF RETURN OF CAPITAL DIS-  
 9           TRIBUTIONS.—Except as otherwise provided by the  
 10          Secretary, a distribution with respect to stock in a  
 11          qualified investment entity which is not a dividend  
 12          and which results in a reduction in the adjusted  
 13          basis of such stock shall be treated as allocable to  
 14          stock acquired by the taxpayer in the order in which  
 15          such stock was acquired.

16          “(4) QUALIFIED INVESTMENT ENTITY.—For  
 17          purposes of this subsection, the term ‘qualified in-  
 18          vestment entity’ means—

19                 “(A) a regulated investment company  
 20                 (within the meaning of section 851), and

21                 “(B) a real estate investment trust (within  
 22                 the meaning of section 856).

23          “(f) OTHER PASS-THROUGH ENTITIES.—

24          “(1) PARTNERSHIPS.—

1           “(A) IN GENERAL.—In the case of a part-  
2           nership, the adjustment made under subsection  
3           (a) at the partnership level shall be passed  
4           through to the partners.

5           “(B) SPECIAL RULE IN THE CASE OF SEC-  
6           TION 754 ELECTIONS.—In the case of a transfer  
7           of an interest in a partnership with respect to  
8           which the election provided in section 754 is in  
9           effect—

10           “(i) the adjustment under section  
11           743(b)(1) shall, with respect to the trans-  
12           feror partner, be treated as a sale of the  
13           partnership assets for purposes of applying  
14           this section, and

15           “(ii) with respect to the transferee  
16           partner, the partnership’s holding period  
17           for purposes of this section in such assets  
18           shall be treated as beginning on the date  
19           of such adjustment.

20           “(2) S CORPORATIONS.—In the case of an S  
21           corporation, the adjustment made under subsection  
22           (a) at the corporate level shall be passed through to  
23           the shareholders.

24           “(3) COMMON TRUST FUNDS.—In the case of a  
25           common trust fund, the adjustment made under sub-

1       section (a) at the trust level shall be passed through  
2       to the participants.

3       “(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

4               “(1) IN GENERAL.—This section shall not apply  
5       to any sale or other disposition of property between  
6       related persons except to the extent that the basis  
7       of such property in the hands of the transferee is a  
8       substituted basis.

9               “(2) RELATED PERSONS DEFINED.—For pur-  
10       poses of this section, the term ‘related persons’  
11       means—

12               “(A) persons bearing a relationship set  
13       forth in section 267(b), and

14               “(B) persons treated as single employer  
15       under subsection (b) or (c) of section 414.

16       “(h) TRANSFERS TO INCREASE INDEXING ADJUST-  
17       MENT.—If any person transfers cash, debt, or any other  
18       property to another person and the principal purpose of  
19       such transfer is to secure or increase an adjustment under  
20       subsection (a), the Secretary may disallow part of all of  
21       such adjustment or increase.

22       “(i) SPECIAL RULES.—For purposes of this section—

23               “(1) TREATMENT OF IMPROVEMENTS, ETC.—If  
24       there is an addition to the adjusted basis of any tan-  
25       gible property or of any stock in a corporation dur-

1       ing the taxable year by reason of an improvement  
2       to such property or a contribution to capital of such  
3       corporation—

4               “(A) such addition shall never be taken  
5       into account under subsection (c)(1)(A) if the  
6       aggregate amount thereof during the taxable  
7       year with respect to such property or stock is  
8       less than \$1,000, and

9               “(B) such addition shall be treated as a  
10      separate asset acquired at the close of such tax-  
11      able year if the aggregate amount thereof dur-  
12      ing the taxable year with respect to such prop-  
13      erty or stock is \$1,000 or more.

14      A rule similar to the rule of the preceding sentence  
15      shall apply to any other portion of an asset to the  
16      extent that separate treatment of such portion is ap-  
17      propriate to carry out the purposes of this section.

18              “(2) ASSETS WHICH ARE NOT INDEXED ASSETS  
19      THROUGHOUT HOLDING PERIOD.—The applicable in-  
20      flation ratio shall be appropriately reduced for peri-  
21      ods during which the asset was not an indexed asset.

22              “(3) TREATMENT OF CERTAIN DISTRIBUTIONS.—A distribution with respect to stock in a  
23      corporation which is not a dividend shall be treated  
24      as a disposition.  
25

1           “(4) SECTION CANNOT INCREASE ORDINARY  
2       LOSS.—To the extent that (but for this paragraph)  
3       this section would create or increase a net ordinary  
4       loss to which section 1231(a)(2) applies or an ordi-  
5       nary loss to which any other provision of this title  
6       applies, such provision shall not apply. The taxpayer  
7       shall be treated as having a long-term capital loss in  
8       an amount equal to the amount of the ordinary loss  
9       to which the preceding sentence applies.

10           “(5) ACQUISITION DATE WHERE THERE HAS  
11       BEEN PRIOR APPLICATION OF SUBSECTION (a)(1)  
12       WITH RESPECT TO THE TAXPAYER.—If there has  
13       been a prior application of subsection (a)(1) to an  
14       asset while such asset was held by the taxpayer, the  
15       date of acquisition of such asset by the taxpayer  
16       shall be treated as not earlier than the date of the  
17       most recent such prior application.

18           “(6) COLLAPSIBLE CORPORATIONS.—The appli-  
19       cation of section 341(a) (relating to collapsible cor-  
20       porations) shall be determined without regard to this  
21       section.

22           “(j) REGULATIONS.—The Secretary shall prescribe  
23       such regulations as may be necessary or appropriate to  
24       carry out the purposes of this section.”



1 (b) CLERICAL AMENDMENT.—The table of sections  
 2 for part II of subchapter O of chapter 1 is amended by  
 3 inserting after the item relating to section 1021 the follow-  
 4 ing new item:

“Sec. 1022. Indexing of certain assets acquired after December  
 31, 1996, for purposes of determining gain or  
 loss.”

5 (c) EFFECTIVE DATE.—

6 (1) IN GENERAL.—The amendments made by  
 7 this section shall apply to the disposition of any  
 8 property the holding period of which begins after  
 9 December 31, 1996.

10 (2) CERTAIN TRANSACTIONS BETWEEN RELAT-  
 11 ED PERSONS.—The amendments made by this sec-  
 12 tion shall not apply to the disposition of any prop-  
 13 erty acquired after December 31, 1996, from a re-  
 14 lated person (as defined in section 1022(g)(2) of the  
 15 Internal Revenue Code of 1986, as added by this  
 16 section) if—

17 (A) such property was so acquired for a  
 18 price less than the property’s fair market value,  
 19 and

20 (B) the amendments made by this section  
 21 did not apply to such property in the hands of  
 22 such related person.

1 (d) ELECTION TO RECOGNIZE GAIN ON ASSETS  
2 HELD ON JANUARY 1, 1997.—For purposes of the Inter-  
3 nal Revenue Code of 1986—

4 (1) IN GENERAL.—A taxpayer may elect to  
5 treat—

6 (A) any readily tradable stock (which is an  
7 indexed asset) held by such taxpayer on Janu-  
8 ary 1, 1997, and not sold before the next busi-  
9 ness day after such date, as having been sold  
10 on such next business day for an amount equal  
11 to its closing market price on such next busi-  
12 ness day (and as having been reacquired on  
13 such next business day for an amount equal to  
14 such closing market price), and

15 (B) any other indexed asset held by the  
16 taxpayer on January 1, 1997, as having been  
17 sold on such date for an amount equal to its  
18 fair market value on such date (and as having  
19 been reacquired on such date for an amount  
20 equal to such fair market value).

21 (2) TREATMENT OF GAIN OR LOSS.—

22 (A) Any gain resulting from an election  
23 under paragraph (1) shall be treated as received  
24 or accrued on the date the asset is treated as  
25 sold under paragraph (1) and shall be recog-

1 nized notwithstanding any provision of the In-  
2 ternal Revenue Code of 1986.

3 (B) Any loss resulting from an election  
4 under paragraph (1) shall not be allowed for  
5 any taxable year.

6 (3) ELECTION.—An election under paragraph  
7 (1) shall be made in such manner as the Secretary  
8 may prescribe and shall specify the assets for which  
9 such election is made. Such an election, once made  
10 with respect to any asset, shall be irrevocable.

11 (4) READILY TRADABLE STOCK.—For purposes  
12 of this subsection, the term “readily tradable stock”  
13 means any stock which, as of January 1, 1997, is  
14 readily tradable on an established securities market  
15 or otherwise.

16 (e) TREATMENT OF PRINCIPAL RESIDENCES.—Prop-  
17 erty held and used by the taxpayer on January 1, 1997,  
18 as his principal residence (within the meaning of section  
19 1034 of the Internal Revenue Code of 1986) shall be treat-  
20 ed—

21 (1) for purposes of subsection (c)(1) of this sec-  
22 tion and section 1022 of such Code, as having a  
23 holding period which begins on January 1, 1997,  
24 and

1           (2) for purposes of section 1022(c)(2)(B)(ii) of  
2       such Code, as having been acquired on January 1,  
3       1997.

4 Subsection (d) shall not apply to property to which this  
5 subsection applies.

○