

105TH CONGRESS
1ST SESSION

H. R. 846

To amend the Internal Revenue Code of 1986 to require gain recognition in the case of certain transactions that are equivalent to sales of financial instruments, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 26, 1997

Mrs. KENNELLY of Connecticut introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to require gain recognition in the case of certain transactions that are equivalent to sales of financial instruments, 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. CONSTRUCTIVE SALES TREATMENT FOR AP-**
4 **PRECIATED FINANCIAL POSITIONS.**

5 (a) IN GENERAL.—Part IV of subchapter P of chap-
6 ter 1 of the Internal Revenue Code of 1986 is amended
7 by adding at the end the following new section:

1 **“SEC. 1259. CONSTRUCTIVE SALES TREATMENT FOR AP-**
2 **PRECIATED FINANCIAL POSITIONS.**

3 “(a) IN GENERAL.—If there is a constructive sale of
4 an appreciated financial position—

5 “(1) the taxpayer shall recognize gain as if such
6 position were sold for its fair market value on the
7 date of such constructive sale (and any gain shall be
8 taken into account for the taxable year which in-
9 cludes such date), and

10 “(2) for purposes of applying this title for peri-
11 ods after the constructive sale—

12 “(A) proper adjustment shall be made in
13 the amount of any gain or loss subsequently re-
14 alized with respect to such position for any gain
15 taken into account by reason of paragraph (1),
16 and

17 “(B) the holding period of such position
18 shall be determined as if such position were
19 originally acquired on the date of such con-
20 structive sale.

21 “(b) APPRECIATED FINANCIAL POSITION.—For pur-
22 poses of this section—

23 “(1) IN GENERAL.—The term ‘appreciated fi-
24 nancial position’ means any position with respect to
25 any stock, debt instrument, or partnership interest
26 if there would be gain were such position sold.

1 “(2) POSITION.—The term ‘position’ means an
2 interest, including a futures or forward contract,
3 short sale, or option.

4 “(c) CONSTRUCTIVE SALE.—For purposes of this
5 section—

6 “(1) IN GENERAL.—A taxpayer shall be treated
7 as having made a constructive sale of an appreciated
8 financial position if the taxpayer (or a related per-
9 son)—

10 “(A) makes a short sale of the same or
11 substantially identical property,

12 “(B) enters into an offsetting notional
13 principal contract with respect to the same or
14 substantially identical property,

15 “(C) enters into a futures or forward con-
16 tract to deliver the same or substantially iden-
17 tical property,

18 “(D) in the case of an appreciated finan-
19 cial position that is a short sale or a contract
20 described in subparagraph (B) or (C) with re-
21 spect to any property, acquires the same or
22 substantially identical property, or

23 “(E) enters into 1 or more other trans-
24 actions (or acquires 1 or more positions) that

1 have substantially the same effect as a trans-
2 action described in any of the preceding sub-
3 paragraphs.

4 “(2) EXCEPTION FOR TRANSACTIONS MARKED
5 TO MARKET.—The term ‘constructive sale’ shall not
6 include any transaction if the appreciated financial
7 position which is part of such transaction is marked
8 to market under section 475 or 1256.

9 “(3) EXCEPTION FOR SALES OF NONPUBLICLY
10 TRADED PROPERTY.—The term ‘constructive sale’
11 shall not include any contract for sale of any stock,
12 debt instrument, or partnership interest which is not
13 a marketable security (as defined in section 453(f))
14 if the sale occurs within 1 year after the date such
15 contract is entered into.

16 “(4) EXCEPTION FOR TRANSACTIONS WHICH
17 ARE CLOSED BY YEAR END.—In applying this sec-
18 tion, there shall be disregarded—

19 “(A) any appreciated financial position
20 which is sold or otherwise disposed of during
21 the taxable year in a transaction in which gain
22 or loss is recognized, and

23 “(B) any other transaction (which would
24 otherwise be treated as a constructive sale) if—

1 “(i) such transaction is closed before
2 the end of the taxable year, and

3 “(ii) in the case of a transaction
4 which is closed during the last 30 days of
5 such taxable year, another transaction with
6 substantially the same effect as the closed
7 transaction is not entered into during the
8 31-day period beginning with the date on
9 which such transaction was closed.

10 “(5) RELATED PERSON.—A person is related to
11 another person with respect to a transaction if—

12 “(A) the relationship is described in sec-
13 tion 267 or 707(b), and

14 “(B) such transaction is entered into with
15 a view toward avoiding the purposes of this sec-
16 tion.

17 “(6) SPECIAL RULE FOR DEBT INSTRU-
18 MENTS.—For purposes of paragraph (1)(A), posi-
19 tions in interest rates shall be treated as positions
20 in property which are substantially identical to debt
21 instruments.

22 “(d) OTHER DEFINITIONS.—For purposes of this
23 section—

1 “(1) FORWARD CONTRACT.—The term ‘forward
2 contract’ includes a fully or partially prepaid for-
3 ward contract.

4 “(2) OFFSETTING NOTIONAL PRINCIPAL CON-
5 TRACT.—The term ‘offsetting notional principal con-
6 tract’ means, with respect to any property, an agree-
7 ment to pay the investment yield (including appre-
8 ciation) on such property for a specified period in
9 exchange for the right to be reimbursed for any de-
10 cline in the value of such property and for other con-
11 sideration.

12 “(e) SPECIAL RULES.—

13 “(1) TREATMENT OF SUBSEQUENT SALE OF
14 POSITION WHICH WAS DEEMED SOLD.—If—

15 “(A) there is a constructive sale of any ap-
16 preciated financial position,

17 “(B) such position is subsequently sold or
18 otherwise disposed of, and

19 “(C) at the time of such sale or disposi-
20 tion, the transaction resulting in the construc-
21 tive sale of such position is open with respect
22 to the taxpayer or any related person,
23 solely for purposes of determining whether the tax-
24 payer has entered into a constructive sale of any

1 other appreciated financial position held by the tax-
2 payer, the taxpayer shall be treated as entering into
3 such transaction immediately after such sale or
4 other disposition.

5 “(2) CERTAIN TRUST INSTRUMENTS TREATED
6 AS STOCK.—For purposes of this section, an interest
7 in a trust which is actively traded (within the mean-
8 ing of section 1092(d)(1)) shall be treated as stock.

9 “(3) MULTIPLE POSITIONS IN PROPERTY.—If
10 there is a constructive sale of a portion of any prop-
11 erty held by the taxpayer, the determination of the
12 specific property which is deemed sold shall be made
13 in the same manner as if the constructive sale were
14 an actual sale; except that property treated as sold
15 by reason of a prior constructive sale that remains
16 open shall be disregarded.

17 “(f) REGULATIONS.—The Secretary shall prescribe
18 such regulations as may be necessary or appropriate to
19 carry out the purposes of this section.”

20 (b) SECURITIES TRADERS MAY ELECT MARK TO
21 MARKET.—Subsection (d) of section 475 (relating to
22 mark to market accounting method for dealers in securi-
23 ties) is amended by adding at the end the following new
24 paragraph:

1 “(4) SECURITIES TRADERS MAY ELECT MARK
2 TO MARKET.—In the case of a person engaged in the
3 trade or business of being an active trader in securi-
4 ties—

5 “(A) such person may elect to be treated
6 as a dealer in securities for purposes of this
7 section, and

8 “(B) securities held by such person in con-
9 nection with such trade or business shall be
10 treated as not held for investment.

11 Such an election may be made without the consent
12 of the Secretary and, if made, shall apply to the tax-
13 able year for which made and all subsequent taxable
14 years unless revoked with the consent of the Sec-
15 retary.”

16 (c) CLERICAL AMENDMENT.—The table of sections
17 for part IV of subchapter P of chapter 1 of such Code
18 is amended by adding at the end the following new item:

 “Sec. 1259. Constructive sales treatment for appreciated financial
 positions.”

19 (d) EFFECTIVE DATE.—

20 (1) IN GENERAL.—Except as provided in para-
21 graph (3), the amendments made by this section
22 shall apply to—

23 (A) any constructive sale after the date of
24 the enactment of this Act, and

1 (B) any constructive sale after January
2 12, 1996, and before the date of the enactment
3 of this Act, but only if, on the date which is 30
4 days after the date of the enactment of this
5 Act, the taxpayer owns the appreciated finan-
6 cial position subject to the constructive sale and
7 the transaction that resulted in the construction
8 sale remains open with respect to the taxpayer
9 or a related person.

10 In a case to which subparagraph (B) applies, section
11 1259 of the Internal Revenue Code of 1986 (as
12 added by this section) shall be applied as if the con-
13 structive sale occurred on the date which is 30 days
14 after the date of the enactment of this Act.

15 (2) SPECIAL RULE.—In the case of a decedent
16 dying after the date of the enactment of this Act,
17 if—

18 (A) there was a constructive sale on or be-
19 fore such date of enactment of any appreciated
20 financial position, and

21 (B) on the day before the date of the dece-
22 dent's death, the transaction resulting in the
23 constructive sale of such position is open with
24 respect to the decedent or any related person
25 and gain has not been recognized under section

1 1259 of the Internal Revenue Code of 1986 (as
2 added by this section),
3 for purposes of such Code, such position (and any
4 property related thereto, as determined under the
5 principles of section 1259(d)(1) of such Code (as so
6 added)) shall be treated as property constituting
7 rights to receive an item of income in respect of a
8 decedent under section 691 of such Code.

9 (3) ELECTION OF SECURITIES TRADERS TO BE
10 TREATED AS DEALERS.—

11 (A) IN GENERAL.—The amendment made
12 by subsection (b) shall apply to taxable years
13 beginning after the date of the enactment of
14 this Act.

15 (B) 5-YEAR SPREAD OF ADJUSTMENTS.—
16 In the case of a taxpayer who elects under sec-
17 tion 475(d)(4) of the Internal Revenue Code of
18 1986 (as added by this section) to change its
19 method of accounting for its first taxable year
20 beginning after the date of the enactment of
21 this Act, the net amount of the adjustments re-
22 quired to be taken into account by the taxpayer
23 under section 481 of the Internal Revenue Code
24 of 1986 shall be taken into account ratably over

1 the 5-taxable year period beginning with such
2 first taxable year.

3 **SEC. 2. LIMITATION ON EXCEPTION FOR INVESTMENT COM-**
4 **PANIES UNDER SECTION 351.**

5 (a) IN GENERAL.—Paragraph (1) of section 351(e)
6 of the Internal Revenue Code of 1986 (relating to excep-
7 tions) is amended by adding at the end the following: “The
8 determination of whether a company is an investment
9 company shall be made by taking into account all stock
10 and securities held by the company, whether or not readily
11 marketable.”

12 (b) EFFECTIVE DATE.—The amendment made by
13 subsection (a) shall apply to transfers after the date of
14 the enactment of this Act in taxable years ending after
15 such date.

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