

105TH CONGRESS
1ST SESSION

S. 501

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, to allow the capital loss deduction for losses on the sale or exchange of an individual's principal residence, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 20, 1997

Mr. MACK (for himself, Mr. SHELBY, Mr. COCHRAN, Mr. D'AMATO, and Mr. HAGEL) introduced the following bill; which was read twice and referred to the Committee on Finance

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, to allow the capital loss deduction for losses on the sale or exchange of an individual's principal residence, 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,*

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as the “Return Capital To The
3 American People Act”.

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

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

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

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

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

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

25 “(d) **TRANSITIONAL RULES.**—

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

3 “(A) the amount taken into account as the
4 net capital gain under subsection (a) shall not
5 exceed the net capital gain determined by only
6 taking into account gains and losses properly
7 taken into account for the portion of the tax-
8 able year on or after January 1, 1997, and

9 “(B) the amount of the net capital gain
10 taken into account in applying section 1(h) for
11 such year shall be reduced by the amount taken
12 into account under subparagraph (A) for such
13 year.

14 “(2) SPECIAL RULES FOR PASS-THRU ENTI-
15 TIES.—

16 “(A) IN GENERAL.—In applying paragraph
17 (1) with respect to any pass-thru entity, the de-
18 termination of when gains and losses are prop-
19 erly taken into account shall be made at the en-
20 tity level.

21 “(B) PASS-THRU ENTITY DEFINED.—For
22 purposes of subparagraph (A), the term ‘pass-
23 thru entity’ means—

24 “(i) a regulated investment company,

25 “(ii) a real estate investment trust,

- 1 “(iii) an S corporation,
- 2 “(iv) a partnership,
- 3 “(v) an estate or trust, and
- 4 “(vi) a common trust fund.”

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

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

11 (c) TECHNICAL AND CONFORMING CHANGES.—

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

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

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

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

22 (4) Paragraph (1) of section 170(e) of such
 23 Code is amended by striking “the amount of gain”
 24 in the material following subparagraph (B)(ii) and
 25 inserting “50 percent of the amount of gain”.

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

3 “(2) CAPITAL GAINS AND LOSSES.—

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

11 “(B) DEDUCTION FOR CAPITAL GAINS.—

12 The deduction under section 1201 shall not be
13 allowed.”

14 (6) The last sentence of section 453A(c)(3) of
15 such Code is amended by striking all that follows
16 “long-term capital gain,” and inserting “the deduc-
17 tion under section 1201 shall be taken into ac-
18 count.”.

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

22 (8) Paragraph (2) of section 527(b) of such
23 Code is hereby repealed.

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

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

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

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

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

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

3 (14) Paragraph (2) of section 801(a) of such
4 Code is hereby repealed.

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

8 (16)(A) Subparagraph (A) of section 852(b)(3)
9 of such Code is amended by striking “, determined
10 as provided in section 1201(a), on” and inserting
11 “of 17.5 percent of”.

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

14 (i) by striking “65 percent” and inserting
15 “82.5 percent”, and

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

18 (17) Clause (ii) of section 857(b)(3)(A) of such
19 Code is amended by striking “determined at the rate
20 provided in section 1201(a) on” and inserting “of
21 17.5 percent of”.

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

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

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

6 “(2) CAPITAL GAINS.—Taxable income from
 7 sources outside the United States shall include gain
 8 from the sale or exchange of capital assets only to
 9 the extent of foreign source capital gain net in-
 10 come.”

11 (B) Paragraph (3) of section 904(b) of such
 12 Code is amended by striking subparagraphs (B),
 13 (D), and (E) and by redesignating subparagraph (C)
 14 as subparagraph (B).

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

17 “(2) the sum of—

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

20 “(B) one-half of the excess of the net long-
 21 term capital loss over the net short-term capital
 22 gain.”

23 (B) So much of paragraph (2) of section
 24 1212(b) of such Code as precedes subparagraph (B)
 25 thereof is amended to read as follows:

1 “(2) SPECIAL RULES.—

2 “(A) ADJUSTMENTS.—

3 “(i) For purposes of determining the
4 excess referred to in paragraph (1)(A),
5 there shall be treated as short-term capital
6 gain in the taxable year an amount equal
7 to the lesser of—

8 “(I) the amount allowed for the
9 taxable year under paragraph (1) or
10 (2) of section 1211(b), or

11 “(II) the adjusted taxable income
12 for such taxable year.

13 “(ii) For purposes of determining the
14 excess referred to in paragraph (1)(B),
15 there shall be treated as short-term capital
16 gain in the taxable year an amount equal
17 to the sum of—

18 “(I) the amount allowed for the
19 taxable year under paragraph (1) or
20 (2) of section 1211(b) or the adjusted
21 taxable income for such taxable year,
22 whichever is the least, plus

23 “(II) the excess of the amount
24 described in subclause (I) over the net
25 short-term capital loss (determined

1 without regard to this subsection) for
 2 such year.”

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

5 “(3) TRANSITIONAL RULE.—

6 “(A) IN GENERAL.—The amount deter-
 7 mined under subclause (II) of paragraph
 8 (2)(A)(ii) for any taxable year shall be reduced
 9 (but not below zero) by the excess of—

10 “(i) the amount of the unused pre-
 11 1998 long-term capital loss for such year,
 12 over

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

16 Section 1211(b)(2)(B) shall be applied without
 17 regard to ‘one-half of’ with respect to such ex-
 18 cess for such taxable year.

19 “(B) UNUSED PRE-1998 LONG-TERM CAP-
 20 ITAL LOSS.—For purposes of this paragraph,
 21 the term ‘unused pre-1998 long-term capital
 22 loss’ means, with respect to a taxable year, the
 23 excess of—

24 “(i) the amount which under para-
 25 graph (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—

“(I) the aggregate amount determined under subparagraph (A)(ii) for all prior taxable years beginning after December 31, 1997, and

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

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

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

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

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

(A) in paragraph (1) by striking “35 percent (or, to the extent provided in regulations, 28 percent)” and inserting “17.5 percent (or, to

1 the extent provided in regulations, 19.8 per-
 2 cent)”, and

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

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

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

9 (28)(A) The second sentence of section
 10 7518(g)(6)(A) of such Code is amended—

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

13 (ii) by striking “28 percent (34 percent”
 14 and inserting “19.8 percent (17.5 percent”.

15 (B) The second sentence of section
 16 607(h)(6)(A) of the Merchant Marine Act, 1936 is
 17 amended—

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

21 (ii) by striking “28 percent (34 percent”
 22 and inserting “19.8 percent (17.5 percent”.

23 (29) The table of sections for part I of sub-
 24 chapter P of chapter 1 of such Code is amended by

1 striking the item relating to section 1201 and insert-
 2 ing the following:

“Sec. 1201. Capital gains deduction.”

3 (d) EFFECTIVE DATES.—

4 (1) IN GENERAL.—Except as otherwise pro-
 5 vided in this subsection, the amendments made by
 6 this section shall apply to taxable years ending after
 7 December 31, 1996.

8 (2) REPEAL OF SECTION 1(h).—The amendment
 9 made by subsection (c)(1) shall apply to taxable
 10 years beginning after January 1, 1997.

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

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

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

20 (6) COORDINATION WITH PRIOR TRANSITION
 21 RULE.—Any amount treated as long-term capital
 22 gain by reason of paragraph (3) of section 1122(h)
 23 of the Tax Reform Act of 1986 shall not be taken
 24 into account for purposes of applying section 1201

1 of the Internal Revenue Code of 1986 (as added by
2 this section).

3 **SEC. 3. INCREASED EXCLUSION AND OTHER MODIFICA-**
4 **TIONS APPLICABLE TO QUALIFIED SMALL**
5 **BUSINESS STOCK.**

6 (a) INCREASED EXCLUSION.—

7 (1) IN GENERAL.—Subsection (a) of section
8 1202 of the Internal Revenue Code of 1986 (50-per-
9 cent exclusion for gain from certain small business
10 stock) is amended—

11 (A) by striking “50 percent” and inserting
12 “75 percent”, and

13 (B) by striking “50-PERCENT” in the
14 heading and inserting “75-PERCENT”.

15 (2) CONFORMING AMENDMENTS.—

16 (A) The heading for section 1202 of such
17 Code is amended by striking “**50-PERCENT**”
18 and inserting “**75-PERCENT**”.

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

23 (b) REDUCTION IN HOLDING PERIOD.—Subsection
24 (a) of section 1202 of such Code is amended by striking
25 “5 years” and inserting “3 years”.

1 (c) EXCLUSION AVAILABLE TO CORPORATIONS.—

2 (1) IN GENERAL.—Subsection (a) of section
3 1202 of such Code is amended by striking “other
4 than a corporation”.

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

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

14 (d) REPEAL OF MINIMUM TAX PREFERENCE.—

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

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

21 (e) STOCK OF LARGER BUSINESSES ELIGIBLE FOR
22 EXCLUSION.—

23 (1) IN GENERAL.—Paragraph (1) of section
24 1202(d) of such Code (defining qualified small busi-

1 ness) is amended by striking “\$50,000,000” each
 2 place it appears and inserting “\$100,000,000”.

3 (2) INFLATION ADJUSTMENT.—Section 1202(d)
 4 of such Code is amended by adding at the end the
 5 following:

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

11 “(A) such dollar amount, multiplied by

12 “(B) the cost-of-living adjustment deter-
 13 mined under section 1(f)(3) for the calendar
 14 year in which the taxable year begins, deter-
 15 mined by substituting ‘calendar year 1997’ for
 16 ‘calendar year 1992’ in subparagraph (B)
 17 thereof.

18 If any amount as adjusted under the preceding sen-
 19 tence is not a multiple of \$10,000, such amount
 20 shall be rounded to the nearest multiple of
 21 \$10,000.”

22 (f) REPEAL OF PER-ISSUER LIMITATION.—Section
 23 1202 of such Code is amended by striking subsection (b).

24 (g) OTHER MODIFICATIONS.—

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

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

6 (B) by striking the last sentence.

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

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

20 (h) QUALIFIED TRADE OR BUSINESS.—Section
 21 1202(e)(3) of such Code (defining qualified trade or busi-
 22 ness) is amended by inserting “and” at the end of sub-
 23 paragraph (C), by striking “, and” at the end of subpara-
 24 graph (D) and inserting a period, and by striking subpara-
 25 graph (E).

1 (i) EFFECTIVE DATES.—

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

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

9 **SEC. 4. ROLLOVER OF GAIN FROM SALE OF QUALIFIED**
10 **STOCK.**

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

15 **“SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL**
16 **BUSINESS STOCK TO ANOTHER QUALIFIED**
17 **SMALL BUSINESS STOCK.**

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

23 “(1) the cost of any qualified small business
24 stock purchased by the taxpayer during the 60-day

1 period beginning on the date of such sale, reduced
2 by

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

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

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

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

12 “(2) ELIGIBLE GAIN.—The term ‘eligible gain’
13 means any gain from the sale or exchange of quali-
14 fied small business stock held for at least 6 months.

15 “(3) PURCHASE.—A taxpayer shall be treated
16 as having purchased any property if, but for para-
17 graph (4), the unadjusted basis of such property in
18 the hands of the taxpayer would be its cost (within
19 the meaning of section 1012).

20 “(4) BASIS ADJUSTMENTS.—If gain from any
21 sale is not recognized by reason of subsection (a),
22 such gain shall be applied to reduce (in the order ac-
23 quired) the basis for determining gain or loss of any
24 qualified small business stock which is purchased by

1 the taxpayer during the 60-day period described in
 2 subsection (a).

3 “(c) SPECIAL RULES FOR TREATMENT OF REPLACE-
 4 MENT STOCK.—

5 “(1) HOLDING PERIOD FOR ACCRUED GAIN.—

6 For purposes of this chapter, gain from the disposi-
 7 tion of any replacement qualified small business
 8 stock shall be treated as gain from the sale or ex-
 9 change of qualified small business stock held at least
 10 6 months to the extent that the amount of such gain
 11 does not exceed the amount of the reduction in the
 12 basis of such stock by reason of subsection (b)(4).

13 “(2) TACKING OF HOLDING PERIOD FOR PUR-
 14 POSES OF DEFERRAL.—Solely for purposes of apply-
 15 ing this section, if any replacement qualified small
 16 business stock is disposed of before the taxpayer has
 17 held such stock for at least 6 months, gain from
 18 such stock shall be treated as eligible gain for pur-
 19 poses of subsection (a).

20 “(3) REPLACEMENT QUALIFIED SMALL BUSI-
 21 NESS STOCK.—For purposes of this subsection, the
 22 term ‘replacement qualified small business stock’
 23 means any qualified small business stock the basis
 24 of which was reduced under subsection (b)(4).”

25 (b) CONFORMING AMENDMENTS.—

1 (1) Section 1016(a)(23) of such Code is amend-
2 ed—

3 (A) by striking “or 1044” and inserting “,
4 1044, or 1045”; and

5 (B) by striking “or 1044(d)” and inserting
6 “, 1044(d), or 1045(b)(4)”.

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

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

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

13 **SEC. 5. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER**
14 **DECEMBER 31, 1996, FOR PURPOSES OF DE-**
15 **TERMINING GAIN OR LOSS.**

16 (a) IN GENERAL.—Part II of subchapter O of chap-
17 ter 1 of the Internal Revenue Code of 1986 (relating to
18 basis rules of general application) is amended by inserting
19 after section 1021 the following new section:

20 **“SEC. 1022. INDEXING OF CERTAIN ASSETS ACQUIRED**
21 **AFTER DECEMBER 31, 1996, FOR PURPOSES**
22 **OF DETERMINING GAIN OR LOSS.**

23 “(a) GENERAL RULE.—

1 “(1) INDEXED BASIS SUBSTITUTED FOR AD-
 2 JUSTED BASIS.—Except as otherwise provided in
 3 this subsection, if an indexed asset which has been
 4 held for more than 3 years is sold or otherwise dis-
 5 posed of, for purposes of this title the indexed basis
 6 of the asset shall be substituted for its adjusted
 7 basis.

8 “(2) EXCEPTION FOR DEPRECIATION, ETC.—
 9 The deductions for depreciation, depletion, and am-
 10 ortization shall be determined without regard to the
 11 application of paragraph (1) to the taxpayer or any
 12 other person.

13 “(b) INDEXED ASSET.—

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

16 “(A) common stock in a C corporation
 17 (other than a foreign corporation), and

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

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

23 “(A) IN GENERAL.—The term ‘indexed
 24 asset’ includes common stock in a foreign cor-

poration which is regularly traded on an established securities market.

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

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

“(ii) stock in a passive foreign investment company (as defined in section 1296),

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

“(iv) stock in a foreign personal holding company (as defined in section 552).

“(C) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS.—An American depository receipt for common stock in a foreign corporation shall be treated as common stock in such corporation.

“(c) INDEXED BASIS.—For purposes of this section—

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

1 “(A) the adjusted basis of the asset, in-
2 creased by

3 “(B) the applicable inflation adjustment.

4 “(2) APPLICABLE INFLATION ADJUSTMENT.—
5 The applicable inflation adjustment for any asset is
6 an amount equal to—

7 “(A) the adjusted basis of the asset, multi-
8 plied by

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

10 “(i) the gross domestic product
11 deflator for the last calendar quarter end-
12 ing before the asset is disposed of, exceeds

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

17 The percentage under subparagraph (B) shall be
18 rounded to the nearest $\frac{1}{10}$ of 1 percentage point.

19 “(3) GROSS DOMESTIC PRODUCT DEFLATOR.—
20 The gross domestic product deflator for any cal-
21 endar quarter is the implicit price deflator for the
22 gross domestic product for such quarter (as shown
23 in the last revision thereof released by the Secretary
24 of Commerce before the close of the following cal-
25 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) ADJUSTMENTS 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-THRU OF PARTNERSHIPS.—For
 2 purposes of this paragraph, a qualified invest-
 3 ment entity which holds a partnership interest
 4 shall be treated (in lieu of holding a partnership
 5 interest) as holding its proportionate share of
 6 the assets held by the partnership.

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

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

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

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

22 “(f) OTHER PASS-THRU ENTITIES.—

23 “(1) PARTNERSHIPS.—

24 “(A) IN GENERAL.—In the case of a part-
 25 nership, the adjustment made under subsection

1 (a) at the partnership level shall be passed
 2 through to the partners.

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

8 “(i) the adjustment under section
 9 743(b)(1) shall, with respect to the trans-
 10 feror partner, be treated as a sale of the
 11 partnership assets for purposes of applying
 12 this section, and

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

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

22 “(3) COMMON TRUST FUNDS.—In the case of a
 23 common trust fund, the adjustment made under sub-
 24 section (a) at the trust level shall be passed through
 25 to the participants.

1 “(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

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

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

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

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

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

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

21 “(1) TREATMENT OF IMPROVEMENTS, ETC.—If
22 there is an addition to the adjusted basis of any tan-
23 gible property or of any stock in a corporation dur-
24 ing the taxable year by reason of an improvement to

1 such property or a contribution to capital of such
2 corporation—

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

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

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

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

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

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.

6 **SEC. 6. CAPITAL LOSS DEDUCTION ALLOWED WITH RE-**
 7 **SPECT TO SALE OR EXCHANGE OF PRINCIPAL**
 8 **RESIDENCE.**

9 (a) IN GENERAL.—Subsection (c) of section 165 of
 10 the Internal Revenue Code of 1986 (relating to limitation
 11 on losses of individuals) is amended by striking “and” at
 12 the end of paragraph (2), by striking the period at the
 13 end of paragraph (3) and inserting “; and”, and by adding
 14 at the end the following new paragraph:

15 “(4) losses arising from the sale or exchange of
 16 the principal residence (within the meaning of sec-
 17 tion 1034) of the taxpayer.”

18 (b) EFFECTIVE DATE.—The amendment made by
 19 subsection (a) shall apply to sales and exchanges after De-
 20 cember 31, 1996, in taxable years ending after such date.

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