

106TH CONGRESS  
1ST SESSION

# H. R. 1703

To amend the Internal Revenue Code of 1986 to prevent the conversion of ordinary income or short-term capital gain into income eligible for the long-term capital gain rates, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

MAY 5, 1999

Mr. NEAL of Massachusetts 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 prevent the conversion of ordinary income or short-term capital gain into income eligible for the long-term capital gain rates, 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. TREATMENT OF GAIN FROM CONSTRUCTIVE**  
4 **OWNERSHIP TRANSACTIONS.**

5 (a) IN GENERAL.—Part IV of subchapter P of chap-  
6 ter 1 of the Internal Revenue Code of 1986 (relating to  
7 special rules for determining capital gains and losses) is

1 amended by inserting after section 1259 the following new  
 2 section:

3 **“SEC. 1260. GAINS FROM CONSTRUCTIVE OWNERSHIP**  
 4 **TRANSACTIONS.**

5 “(a) IN GENERAL.—If the taxpayer has gain from  
 6 a constructive ownership transaction with respect to any  
 7 financial asset and such gain would (without regard to this  
 8 section) be treated as a long-term capital gain—

9 “(1) such gain shall be treated as short-term  
 10 capital gain to the extent that such gain exceeds the  
 11 net underlying long-term capital gain, and

12 “(2) to the extent such gain is treated as a  
 13 long-term capital gain after the application of para-  
 14 graph (1), the determination of the capital gain rate  
 15 (or rates) applicable to such gain under section 1(h)  
 16 shall be determined on the basis of the respective  
 17 rate (or rates) that would have been applicable to  
 18 the net underlying long-term capital gain.

19 “(b) INTEREST CHARGE ON DEFERRAL OF GAIN  
 20 RECOGNITION.—

21 “(1) IN GENERAL.—If any gain is treated as  
 22 short-term capital gain for any taxable year by rea-  
 23 son of subsection (a)(1), the tax imposed by this  
 24 chapter for such taxable year shall be increased by  
 25 the amount of interest determined under paragraph

1 (2) with respect to each prior taxable year during  
2 any portion of which the constructive ownership  
3 transaction was open. Any amount payable under  
4 this paragraph shall be taken into account in com-  
5 puting the amount of any deduction allowable to the  
6 taxpayer for interest paid or accrued during such  
7 taxable year.

8 “(2) AMOUNT OF INTEREST.—The amount of  
9 interest determined under this paragraph with re-  
10 spect to a prior taxable year is the amount of inter-  
11 est which would have been imposed under section  
12 6601 on the underpayment of tax for such year  
13 which would have resulted if the gain (which is  
14 treated as short-term gain by reason of subsection  
15 (a)(1)) had been included in gross income in the tax-  
16 able years in which it accrued (determined by treat-  
17 ing the gain as accruing at a constant rate equal to  
18 the applicable Federal rate as in effect on the day  
19 the transaction closed). The period during which  
20 such interest shall accrue shall end on the due date  
21 (without extensions) for the return of tax imposed  
22 by this chapter for the taxable year in which such  
23 transaction closed.

24 “(3) APPLICABLE FEDERAL RATE.—For pur-  
25 poses of paragraph (2), the applicable Federal rate

1 is the applicable Federal rate determined under  
 2 1274(d) (compounded semiannually) which would  
 3 apply to a debt instrument with a term equal to the  
 4 period the transaction was open.

5 “(4) NO CREDITS AGAINST INCREASE IN TAX.—  
 6 Any increase in tax under paragraph (1) shall not  
 7 be treated as tax imposed by this chapter for pur-  
 8 poses of determining—

9 “(A) the amount of any credit allowable  
 10 under this chapter, or

11 “(B) the amount of the tax imposed by  
 12 section 55.

13 “(c) FINANCIAL ASSET.—For purposes of this  
 14 section—

15 “(1) IN GENERAL.—The term ‘financial asset’  
 16 means—

17 “(A) any equity interest in any pass-thru  
 18 entity, and

19 “(B) to the extent provided in  
 20 regulations—

21 “(i) any debt instrument, and

22 “(ii) any stock in a corporation which  
 23 is not a pass-thru entity.

24 “(2) PASS-THRU ENTITY.—For purposes of  
 25 paragraph (1), the term ‘pass-thru entity’ means—

1 “(A) a regulated investment company,

2 “(B) a real estate investment trust,

3 “(C) an S corporation,

4 “(D) a partnership,

5 “(E) a trust,

6 “(F) a common trust fund,

7 “(G) a passive foreign investment company

8 (as defined in section 1297),

9 “(H) a foreign personal holding company,

10 and

11 “(I) a foreign investment company (as de-  
12 fined in section 1246(b)).

13 “(d) CONSTRUCTIVE OWNERSHIP TRANSACTION.—

14 For purposes of this section—

15 “(1) IN GENERAL.—The taxpayer shall be  
16 treated as having entered into a constructive owner-  
17 ship transaction with respect to any financial asset  
18 if the taxpayer—

19 “(A) holds a long position under a notional  
20 principal contract with respect to the financial  
21 asset,

22 “(B) enters into a forward or futures con-  
23 tract to acquire the financial asset,

24 “(C) is the holder of a call option, and is  
25 the grantor of a put option, with respect to the

1 financial asset and such options have substan-  
2 tially equal strike prices and substantially con-  
3 temporaneous maturity dates, or

4 “(D) enters into 1 or more other trans-  
5 actions (or acquires 1 or more positions) that  
6 have substantially the same effect as a trans-  
7 action described in any of the preceding sub-  
8 paragraphs.

9 “(2) EXCEPTION FOR POSITIONS WHICH ARE  
10 MARKED TO MARKET.—This section shall not apply  
11 to any constructive ownership transaction if all of  
12 the positions which are part of such transaction are  
13 marked to market under any provision of this title  
14 or the regulations thereunder.

15 “(3) LONG POSITION UNDER NOTIONAL PRIN-  
16 CIPAL CONTRACT.—A person shall be treated as  
17 holding a long position under a notional principal  
18 contract with respect to any financial asset if such  
19 person—

20 “(A) has the right to be paid (or receive  
21 credit for) all or substantially all of the invest-  
22 ment yield (including appreciation) on such fi-  
23 nancial asset for a specified period, and

1                   “(B) is obligated to reimburse (or provide  
2                   credit for) all or substantially all of any decline  
3                   in the value of such financial asset.

4                   “(4) FORWARD CONTRACT.—The term ‘forward  
5                   contract’ means any contract to acquire in the fu-  
6                   ture (or provide or receive credit for the future value  
7                   of) any financial asset.

8                   “(e) NET UNDERLYING LONG-TERM CAPITAL  
9 GAIN.—For purposes of this section, in the case of any  
10 constructive ownership transaction with respect to any fi-  
11 nancial asset, the term ‘net underlying long-term capital  
12 gain’ means the aggregate net capital gain that the tax-  
13 payer would have had if—

14                   “(1) the financial asset had been acquired for  
15                   fair market value on the date such transaction was  
16                   opened and sold for fair market value on the date  
17                   such transaction was closed, and

18                   “(2) only gains and losses that would have re-  
19                   sulted from the deemed ownership under paragraph  
20                   (1) were taken into account.

21 The amount of the net underlying long-term capital gain  
22 with respect to any financial asset shall be treated as zero  
23 unless the amount thereof is established by clear and con-  
24 vincing evidence.

1       “(f) SPECIAL RULE WHERE TAXPAYER TAKES DE-  
2 LIVERY.—Except as provided in regulations prescribed by  
3 the Secretary, if a constructive ownership transaction is  
4 closed by reason of taking delivery, this section shall be  
5 applied as if the taxpayer had sold all the contracts, op-  
6 tions, or other positions which are part of such transaction  
7 for fair market value on the closing date. The amount of  
8 gain recognized under the preceding sentence shall not ex-  
9 ceed the amount of gain treated as short-term gain under  
10 subsection (a). Proper adjustments shall be made in the  
11 amount of any gain or loss subsequently realized for gain  
12 recognized under this subsection.

13       “(g) REGULATIONS.—The Secretary shall prescribe  
14 such regulations as may be necessary or appropriate to  
15 carry out the purposes of this section, including regula-  
16 tions permitting taxpayers to mark to market constructive  
17 ownership transactions in lieu of applying this section.”.

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

“Sec. 1260. Gains from constructive ownership transactions.”.

21       (c) EFFECTIVE DATE.—The amendments made by  
22 this section shall apply to gains recognized after the date  
23 of the enactment of this Act; except that such amendments  
24 shall not apply to transactions entered into before Feb-



February 5, 1998, and not extended or substantially modified  
on or after such date.

