

106TH CONGRESS
1ST SESSION

S. 53

To amend the Internal Revenue Code of 1986 to provide a reduction in the capital gain rates for all taxpayers and a partial dividend income exclusion for individuals, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 19, 1999

Mr. KYL (for himself and Mr. COVERDELL) 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 a reduction in the capital gain rates for all taxpayers and a partial dividend income exclusion for individuals, 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 “Capital Gains and Div-
5 idend Income Reform Act of 1998”.

1 **SEC. 2. 70-PERCENT CAPITAL GAINS DEDUCTION FOR TAX-**
 2 **PAYERS OTHER THAN CORPORATIONS.**

3 (a) IN GENERAL.—Section 1202 of the Internal Rev-
 4 enue Code of 1986 is amended to read as follows:

5 **“SEC. 1202. CAPITAL GAINS DEDUCTION.**

6 “(a) GENERAL RULE.—If for any taxable year a tax-
 7 payer other than a corporation has a net capital gain, 70
 8 percent of such gain shall be a deduction from gross in-
 9 come.

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

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

24 “(d) TRANSITIONAL RULE.—

1 “(1) IN GENERAL.—In the case of a taxable
 2 year which includes January 1 of the year following
 3 the date of enactment of this section—

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

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

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

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

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

25 “(i) a regulated investment company,

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

6 (b) DEDUCTION ALLOWABLE IN COMPUTING AD-
 7 JUSTED GROSS INCOME.—Section 62(a) of the Internal
 8 Revenue Code of 1986 (defining adjusted gross income)
 9 is amended by inserting after paragraph (17) the following
 10 new paragraph:

11 “(18) LONG-TERM CAPITAL GAINS.—The de-
 12 duction allowed by section 1202.”.

13 (c) CONFORMING AMENDMENTS.—

14 (1) Section 1 of the Internal Revenue Code of
 15 1986 is amended by striking subsection (h).

16 (2) Section 170(e)(1) of such Code is amended
 17 by striking “the amount of gain” in the material fol-
 18 lowing subparagraph (B)(ii) and inserting “30 per-
 19 cent (100 percent in the case of a corporation) of
 20 the amount of gain”.

21 (3) Section 172(d)(2)(B) of such Code is
 22 amended to read as follows:

23 “(B) the deduction under section 1202
 24 shall not be allowed.”.

1 (4) The last sentence of section 453A(c)(3) of
2 such Code is amended by striking all that follows
3 “long-term capital gain,” and inserting “the maxi-
4 mum rate on net capital gain under section 1201 or
5 the deduction under section 1202 (whichever is ap-
6 propriate) shall be taken into account.”.

7 (5) Section 642(c)(4) of such Code is amended
8 to read as follows:

9 “(4) ADJUSTMENTS.—To the extent that the
10 amount otherwise allowable as a deduction under
11 this subsection consists of gain from the sale or ex-
12 change of capital assets held for more than 1 year,
13 proper adjustment shall be made for any deduction
14 allowable to the estate or trust under section 1202
15 (relating to capital gains deduction). In the case of
16 a trust, the deduction allowed by this subsection
17 shall be subject to section 681 (relating to unrelated
18 business income).”.

19 (6) The last sentence of section 643(a)(3) of
20 such Code is amended to read as follows: “The de-
21 duction under section 1202 (relating to capital gains
22 deduction) shall not be taken into account.”.

23 (7) Section 643(a)(6)(C) of such Code is
24 amended by inserting “(i)” before “there shall” and
25 by inserting before the period “, and (ii) the deduc-

tion under section 1202 (relating to capital gains deduction) shall not be taken into account”.

(8)(A) Section 904(b)(2) of such Code is amended by striking subparagraph (A), by redesignating subparagraph (B) as subparagraph (A), and by inserting after subparagraph (A) (as so redesignated) the following:

“(B) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income.”.

(B) Section 904(b)(2)(A) of such Code, as so redesignated, is amended—

(i) by striking all that precedes clause (i) and inserting the following:

“(A) CORPORATIONS.—In the case of a corporation—”, and

(ii) in clause (i), by striking “in lieu of applying subparagraph (A),”.

(C) Section 904(b)(3) of such Code is amended by striking subparagraphs (D) and (E) and inserting the following:

1 “(D) RATE DIFFERENTIAL PORTION.—The
 2 rate differential portion of foreign source net
 3 capital gain, net capital gain, or the excess of
 4 net capital gain from sources within the United
 5 States over net capital gain, as the case may
 6 be, is the same proportion of such amount as
 7 the excess of the highest rate of tax specified in
 8 section 11(b) over the alternative rate of tax
 9 under section 1201(a) bears to the highest rate
 10 of tax specified in section 11(b).”.

11 (D) Section 593(b)(2)(D)(v) of such Code is
 12 amended—

13 (i) by striking “if there is a capital gain
 14 rate differential (as defined in section
 15 904(b)(3)(D)) for the taxable year,” and

16 (ii) by striking “section 904(b)(3)(E)” and
 17 inserting “section 904(b)(3)(D)”.

18 (9) Section 1044(d) of such Code is amended
 19 by striking the last sentence.

20 (10)(A) Section 1211(b)(2) of such Code is
 21 amended to read as follows:

22 “(2) the sum of—

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

1 “(B) one-half of the excess of the net long-
 2 term capital loss over the net short-term capital
 3 gain.”.

4 (B) So much of section 1212(b)(2) of such
 5 Code as precedes subparagraph (B) thereof is
 6 amended to read as follows:

7 “(2) SPECIAL RULES.—

8 “(A) ADJUSTMENTS.—

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

14 “(I) the amount allowed for the
 15 taxable year under paragraph (1) or
 16 (2) of section 1211(b), or

17 “(II) the adjusted taxable income
 18 for such taxable year.

19 “(ii) For purposes of determining the
 20 excess referred to in paragraph (1)(B),
 21 there shall be treated as short-term capital
 22 gain in the taxable year an amount equal
 23 to the sum of—

24 “(I) the amount allowed for the
 25 taxable year under paragraph (1) or

1 (2) of section 1211(b) or the adjusted
 2 taxable income for such taxable year,
 3 whichever is the least, plus

4 “(II) the excess of the amount
 5 described in subclause (I) over the net
 6 short-term capital loss (determined)
 7 without regard to this subsection) for
 8 such year.”.

9 (C) Section 1212(b) of such Code is amended
 10 by adding at the end of the following:

11 “(3) TRANSITIONAL RULE.—In the case of any
 12 amount which, under this subsection and section
 13 1211(b) (as in effect for taxable year beginning be-
 14 fore January 1, 1999), is treated as a capital loss
 15 in the first taxable year beginning after December
 16 31, 1998, paragraph (2) and section 1211(b) (as so
 17 in effect) shall apply (and paragraph (2) and section
 18 1211(b) as in effect for taxable years beginning
 19 after December 31, 1998, shall not apply) to the ex-
 20 tent such amount exceeds the total of any capital
 21 gain net income (determined without regard to this
 22 subsection) for taxable years beginning after Decem-
 23 ber 31, 1998.”.

24 (11) Section 1402(i)(1) of such Code is amend-
 25 ed by inserting“, and the deduction provided by sec-

1 tion 1202 shall not apply” before the period at the
2 end thereof.

3 (12) Section 1445(e) of such Code is
4 amended—

5 (A) in paragraph (1), by striking “35 per-
6 cent (or, to the extent provided in regulations,
7 20 percent)” and inserting “22 percent (or, to
8 the extent provided in regulation, 15.6 per-
9 cent)”, and

10 (B) in paragraph (2), by striking “35 per-
11 cent” and inserting “22 percent”.

12 (13)(A) The second sentence of section
13 7518(g)(6)(A) of such Code is amended—

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

16 (ii) by striking “20 percent (34 percent”
17 and inserting “15.6 percent (22 percent”.

18 (B) The second sentence of section
19 607(h)(6)(A) of the Merchant Marine Act, 1936 is
20 amended—

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

24 (ii) by striking “20 percent (34 percent”
25 and inserting “15.6 percent (22 percent”.

1 (14) The item relating to section 1202 in the
2 table of sections for part I of subchapter P of chap-
3 ter 1 of such Code is amended to read as follows:

 “Sec. 1202. Capital gains deduction.”.

4 (d) EFFECTIVE DATES.—

5 (1) IN GENERAL.—Except as otherwise pro-
6 vided in this subsection, the amendments, made by
7 this section apply to taxable years ending after De-
8 cember 31 of the year which includes the date of en-
9 actment of this Act.

10 (2) REPEAL OF SECTION 1(h).—The amend-
11 ment made by subsection (c)(1) applies to taxable
12 years beginning on or after January 1 of the year
13 following the date of enactment of this Act.

14 (3) CONTRIBUTIONS.—The amendment made
15 by subsection (c)(2) applies to contributions on or
16 after January 1 of the year following the date of en-
17 actment of this Act.

18 (4) USE OF LONG-TERM LOSSES.—The amend-
19 ments made by subsection (c)(10) apply to taxable
20 years beginning on or after January 1 of the second
21 year following the date of enactment of this Act.

22 (5) WITHHOLDING.—The amendments made by
23 subsection (c)(12) apply only to amounts paid on or
24 after January 1 of the year following the date of en-
25 actment of this Act.

1 **SEC. 3. REDUCTION OF ALTERNATIVE CAPITAL GAIN TAX**
 2 **FOR CORPORATIONS.**

3 (a) IN GENERAL.—Section 1201(a)(2) of the Internal
 4 Revenue Code of 1986 (relating to alternative tax for cor-
 5 porations) is amended by striking “35 percent” and in-
 6 serting “22 percent”.

7 (b) TRANSITIONAL RULE.—Section 1201(b) of the
 8 Internal Revenue Code of 1986 is amended to read as fol-
 9 lows:

10 “(b) TRANSITIONAL RULE.—

11 “(1) IN GENERAL.—In applying this section,
 12 net capital gain for any taxable year shall not exceed
 13 the net capital gain determined by taking into ac-
 14 count only gains and losses properly taken into ac-
 15 count for the portion of the taxable year on or after
 16 January 1 of the year following the date of enact-
 17 ment of this subsection.

18 “(2) SPECIAL RULE FOR PASS-THRU ENTI-
 19 TIES.—Section 1202(d)(2) shall apply for purposes
 20 of paragraph (1).”.

21 (c) CONFORMING AMENDMENT.—Section
 22 852(b)(3)(D)(iii) of the Internal Revenue Code of 1986
 23 is amended by striking “65 percent” and inserting “78
 24 percent”.

25 (d) EFFECTIVE DATE.—The amendments made by
 26 this section apply to taxable years ending after December

1 31 of the year which includes the date of enactment of
2 this Act.

3 **SEC. 4. 70-PERCENT EXCLUSION OF DIVIDEND INCOME**
4 **FROM TAX.**

5 (a) IN GENERAL.—Part III of subchapter B of chap-
6 ter 1 of the Internal Revenue Code of 1986 (relating to
7 amounts specifically excluded from gross income) is
8 amended by inserting after section 115 the following new
9 section:

10 **“SEC. 116. 70-PERCENT EXCLUSION OF DIVIDENDS RE-**
11 **CEIVED BY INDIVIDUALS.**

12 “(a) EXCLUSION FROM GROSS INCOME.—Gross in-
13 come does not include 70 percent of the amounts received
14 during the taxable year by an individual as dividends from
15 domestic corporations.

16 “(b) CERTAIN DIVIDENDS EXCLUDED.—Subsection
17 (a) shall not apply to any dividend from a corporation
18 which, for the taxable year of the corporation in which
19 the distribution is made, or for the next preceding taxable
20 year of the corporation, is a corporation exempt from tax
21 under section 501 (relating to certain charitable, etc., or-
22 ganization) or section 521 (relating to farmers’ coopera-
23 tive associations).

24 “(c) SPECIAL RULES.—For purposes of this
25 section—

1 “(1) EXCLUSION NOT TO APPLY TO CAPITAL
 2 GAIN DIVIDENDS FROM REGULATED INVESTMENT
 3 COMPANIES AND REAL ESTATE INVESTMENT
 4 TRUSTS.—

“For treatment of capital gain dividends, see sections 854(a) and 857(c).

5 “(2) CERTAIN NONRESIDENT ALIENS INELI-
 6 GIBLE FOR EXCLUSION.—In the case of a non-
 7 resident alien individual, subsection (a) shall apply
 8 only—

9 “(A) in determining the tax imposed for
 10 the taxable year pursuant to section 871(b)(1)
 11 and only in respect of dividends which are effec-
 12 tively connected with the conduct of a trade or
 13 business within the United States, or

14 “(B) in determining the tax imposed for
 15 the taxable year pursuant to section 877(b).

16 “(3) DIVIDENDS FROM EMPLOYEE STOCK OWN-
 17 ERSHIP PLANS.—Subsection (a) shall not apply to
 18 any dividend described in section 404(k).”

19 (b) CONFORMING AMENDMENTS.—

20 (1)(A) Subparagraph (A) of section 135(c)(4)
 21 of the Internal Revenue Code of 1986 is amended by
 22 inserting “116,” before “137”.

23 (B) Subsection (d) of section 135 of such Code
 24 is amended by redesignating paragraph (4) as para-

1 graph (5) and by inserting after paragraph (3) the
2 following new paragraph:

3 “(4) COORDINATION WITH SECTION 116.—This
4 section shall be applied before section 116.”

5 (2) Subsection (c) of section 584 of such Code
6 is amended by adding at the end thereof the follow-
7 ing new flush sentence:

8 “The proportionate share of each participant in the
9 amount of dividends received by the common trust fund
10 and to which section 116 applies shall be considered for
11 purposes of such section as having been received by such
12 participant.”

13 (3) Subsection (a) of section 643 of such Code
14 is amended by redesignating paragraph (7) as para-
15 graph (8) and by inserting after paragraph (6) the
16 following new paragraph:

17 “(7) DIVIDENDS.—There shall be included the
18 amount of any dividends excluded from gross income
19 pursuant to section 116.”

20 (4) Section 854(a) of such Code is amended by
21 inserting “section 116 (relating to partial exclusion
22 of dividends received by individuals) and” after “For
23 purposes of”.

24 (5) Section 857(c) of such Code is amended to
25 read as follows:

1 “(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RE-
2 CEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

3 “(1) TREATMENT FOR SECTION 116.—For pur-
4 poses of section 116 (relating to partial exclusion of
5 dividends received by individuals), a capital gain div-
6 idend (as defined in subsection (b)(3)(C)) received
7 from a real estate investment trust which meets the
8 requirements of this part shall not be considered as
9 a dividend.

10 “(2) TREATMENT FOR SECTION 243.—For pur-
11 poses of section 243 (relating to deductions for divi-
12 dends received by corporations), a dividend received
13 from a real estate investment trust which meets the
14 requirements of this part shall not be considered as
15 a dividend.”

16 (6) The table of sections for part III of sub-
17 chapter B of chapter 1 of such Code is amended by
18 inserting after the item relating to section 115 the
19 following new item:

“Sec. 116. 70-percent exclusion of dividends received by individ-
uals.”

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years ending after De-
22 cember 31 of the year which includes the date of enact-
23 ment of this Act.

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