

108TH CONGRESS
1ST SESSION

S. 26

To amend the Internal Revenue Code of 1986 to provide that dividend and interest income of individuals not be taxed at rates in excess of the maximum capital gains rate.

IN THE SENATE OF THE UNITED STATES

JANUARY 7, 2003

Mrs. HUTCHISON 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 that dividend and interest income of individuals not be taxed at rates in excess of the maximum capital gains rate.

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. DIVIDENDS AND INTEREST OF INDIVIDUALS**

4 **TAXED AT CAPITAL GAIN RATES.**

5 (a) IN GENERAL.—Section 1(h) of the Internal Rev-
6 enue Code of 1986 (relating to maximum capital gains
7 rate) is amended by adding at the end the following new
8 paragraph:

1 “(13) DIVIDENDS AND INTEREST TAXED AS
2 NET CAPITAL GAIN.—

3 “(A) IN GENERAL.—For purposes of this
4 subsection, the term ‘net capital gain’ means
5 net capital gain (determined without regard to
6 this paragraph), increased by qualified dividend
7 income and qualified interest income.

8 “(B) QUALIFIED DIVIDEND INCOME.—For
9 purposes of this paragraph—

10 “(i) IN GENERAL.—The term ‘quali-
11 fied dividend income’ means dividends re-
12 ceived from domestic corporations during
13 the taxable year.

14 “(ii) CERTAIN DIVIDENDS EX-
15 CLUDED.—Such term shall not include—

16 “(I) any dividend from a corpora-
17 tion which for the taxable year of the
18 corporation in which the distribution
19 is made, or the preceding taxable
20 year, is a corporation exempt from tax
21 under section 501 or 521,

22 “(II) any amount allowed as a
23 deduction under section 591 (relating
24 to deduction for dividends paid by
25 mutual savings banks, etc.), and

1 “(III) any dividend described in
2 section 404(k).

3 “(iii) MINIMUM HOLDING PERIOD.—
4 Such term shall not include any dividend
5 on any share of stock with respect to which
6 the holding period requirements of section
7 246(c) are not met.

8 “(C) QUALIFIED INTEREST INCOME.—For
9 purposes of this paragraph, the term ‘qualified
10 interest income’ means—

11 “(i) interest on deposits with a bank
12 (as defined in section 581),

13 “(ii) amounts (whether or not des-
14 ignated as interest) paid, in respect of de-
15 posits, investment certificates, or
16 withdrawable or repurchasable shares,
17 by—

18 “(I) a mutual savings bank, co-
19 operative bank, domestic building and
20 loan association, industrial loan asso-
21 ciation or bank, or credit union, or

22 “(II) any other savings or thrift
23 institution which is chartered and su-
24 pervised under Federal or State law,

1 the deposits or accounts in which are in-
2 sured under Federal or State law or which
3 are protected and guaranteed under State
4 law,

5 “(iii) interest on—

6 “(I) evidences of indebtedness
7 (including bonds, debentures, notes,
8 and certificates) issued by a domestic
9 corporation in registered form, and

10 “(II) to the extent provided in
11 regulations prescribed by the Sec-
12 retary, other evidences of indebtedness
13 issued by a domestic corporation of a
14 type offered by corporations to the
15 public,

16 “(iv) interest on obligations of the
17 United States, a State, or a political sub-
18 division of a State (not excluded from
19 gross income of the taxpayer under any
20 other provision of law), and

21 “(v) interest attributable to participa-
22 tion shares in a trust established and
23 maintained by a corporation established
24 pursuant to Federal law.

25 “(D) SPECIAL RULES.—

1 “(i) AMOUNTS TAKEN INTO ACCOUNT
2 AS INVESTMENT INCOME.—Qualified divi-
3 dend income and qualified interest income
4 shall not include any amount which the
5 taxpayer takes into account as investment
6 income under section 163(d)(4)(B).

7 “(ii) NONRESIDENT ALIENS.—In the
8 case of a nonresident alien individual, sub-
9 paragraph (A) shall apply only—

10 “(I) in determining the tax im-
11 posed for the taxable year pursuant to
12 section 871(b) and only in respect of
13 amounts which are effectively con-
14 nected with the conduct of a trade or
15 business within the United States,
16 and

17 “(II) in determining the tax im-
18 posed for the taxable year pursuant to
19 section 877.

20 “(iii) TREATMENT OF DIVIDENDS
21 FROM REGULATED INVESTMENT COMPA-

1 NIES AND REAL ESTATE INVESTMENT
2 TRUSTS.—

“For treatment of dividends from regulated investment companies and real estate investment trusts, see sections 854 and 857.”

3 (b) EXCLUSION OF DIVIDENDS AND INTEREST FROM
4 INVESTMENT INCOME.—Subparagraph (B) of section
5 163(d)(4) of the Internal Revenue Code of 1986 (defining
6 net investment income) is amended by adding at the end
7 the following flush sentence:

8 “Such term shall include qualified dividend in-
9 come (as defined in section 1(h)(13)(B)) or
10 qualified interest income (as defined in section
11 1(h)(13)(C)) only to the extent the taxpayer
12 elects to treat such income as investment in-
13 come for purposes of this subsection.”

14 (c) TREATMENT OF DIVIDENDS FROM REGULATED
15 INVESTMENT COMPANIES.—

16 (1) Subsection (a) of section 854 of the Inter-
17 nal Revenue Code of 1986 (relating to dividends re-
18 ceived from regulated investment companies) is
19 amended by inserting “section 1(h)(13) (relating to
20 maximum rate of tax on dividends and interest)
21 and” after “For purposes of”.

22 (2) Paragraph (1) of section 854(b) of such
23 Code (relating to other dividends) is amended by re-
24 designating subparagraph (B) as subparagraph (C)

1 and by inserting after subparagraph (A) the fol-
2 lowing new subparagraph:

3 “(B) MAXIMUM RATE UNDER SECTION
4 1(h).—

5 “(i) IN GENERAL.—If the sum of the
6 aggregate dividends received, and the ag-
7 gregate interest described in section
8 1(h)(13)(C) received, by a regulated invest-
9 ment company during any taxable year is
10 less than 95 percent of its gross income,
11 then, in computing the maximum rate
12 under section 1(h)(13), rules similar to the
13 rules of subparagraph (A) shall apply.

14 “(ii) GROSS INCOME.—For purposes
15 of clause (i), in the case of 1 or more sales
16 or other dispositions of stock or securities,
17 the term ‘gross income’ includes only the
18 excess of—

19 “(I) the net short-term capital
20 gain from such sales or dispositions,
21 over

22 “(II) the net long-term capital
23 loss from such sales or dispositions.”

24 (3) Subparagraph (C) of section 854(b)(1) of
25 such Code, as redesignated by paragraph (2), is

1 amended by striking “subparagraph (A)” and insert-
2 ing “subparagraph (A) or (B)”.

3 (4) Paragraph (2) of section 854(b) of such
4 Code is amended by inserting “the maximum rate
5 under section 1(h)(13) and” after “for purposes of”.

6 (d) TREATMENT OF DIVIDENDS RECEIVED FROM
7 REAL ESTATE INVESTMENT TRUSTS.—Section 857(c) of
8 the Internal Revenue Code of 1986 (relating to restric-
9 tions applicable to dividends received from real estate in-
10 vestment trusts) is amended to read as follows:

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

13 “(1) IN GENERAL.—For purposes of section
14 1(h)(13) (relating to maximum rate of tax on divi-
15 dends and interest) and section 243 (relating to de-
16 ductions received by corporations), a dividend re-
17 ceived from a real estate investment trust which
18 meets the requirements of this part shall not be con-
19 sidered a dividend.

20 “(2) TREATMENT AS INTEREST.—

21 “(A) IN GENERAL.—For purposes of sec-
22 tion 1(h)(13), in the case of a dividend (other
23 than a capital gain dividend, as defined in sub-
24 section (b)(3)(C)) received from a real estate
25 investment trust which meets the requirements

1 of this part for the taxable year in which it
2 paid—

3 “(i) such dividend shall be treated as
4 interest if the aggregate interest received
5 by the real estate investment trust for the
6 taxable year equals or exceeds 75 percent
7 of its gross income, or

8 “(ii) if clause (i) does not apply, the
9 portion of such dividend which bears the
10 same ratio to the amount of such dividend
11 as the aggregate interest received bears to
12 gross income shall be treated as interest.

13 “(B) ADJUSTMENTS TO GROSS INCOME
14 AND AGGREGATE INTEREST RECEIVED.—For
15 purposes of subparagraph (B)—

16 “(i) gross income does not include the
17 net capital gain,

18 “(ii) gross income and aggregate in-
19 terest received shall each be reduced by so
20 much of the deduction allowable by section
21 163 for the taxable year (other than for in-
22 terest on mortgages on real property
23 owned by the real estate investment trust)
24 as does not exceed aggregate interest re-
25 ceived by the taxable year, and

1 “(iii) gross income shall be reduced by
2 the sum of the taxes imposed by para-
3 graphs (4), (5), and (6) of section 857(b).

4 “(C) AGGREGATE INTEREST RECEIVED.—
5 For purposes of this subsection, aggregate in-
6 terest received shall be computed by taking into
7 account only interest which is described in sec-
8 tion 1(13)(C).

9 “(D) NOTICE TO SHAREHOLDERS.—The
10 amount of any distribution by a real estate in-
11 vestment trust which may be taken into account
12 as interest for purposes of section 1(h)(13)
13 shall not exceed the amount so designated by
14 the trust in a written notice to its shareholders
15 mailed not later than 45 days after the close of
16 its taxable year.”

17 (e) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to taxable years beginning after
19 December 31, 2002.

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