

104<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

# S. 959

To amend the Internal Revenue Code of 1986 to encourage capital formation through reductions in taxes on capital gains, and for other purposes.

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## IN THE SENATE OF THE UNITED STATES

JUNE 22 (legislative day, JUNE 19), 1995

Mr. HATCH (for himself, Mr. LIEBERMAN, and Mr. FAIRCLOTH) introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to encourage capital formation through reductions in taxes on capital gains, 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; AMENDMENT OF 1986 CODE.**

4 (a) SHORT TITLE.—This Act may be cited as the  
5 “Capital Formation Act of 1995”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-  
7 wise expressly provided, whenever in this Act an amend-  
8 ment or repeal is expressed in terms of an amendment  
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-  
2 sion of the Internal Revenue Code of 1986.

3           **TITLE I—CAPITAL GAINS**  
4                   **REFORM**  
5 **Subtitle A—Capital Gains Deduc-**  
6 **tion for Taxpayers Other Than**  
7 **Corporations**

8 **SEC. 101. CAPITAL GAINS DEDUCTION.**

9           (a) **IN GENERAL.**—Part I of subchapter P of chapter  
10 1 (relating to treatment of capital gains) is amended by  
11 redesignating section 1202 as section 1203 and by insert-  
12 ing after section 1201 the following new section:

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

14           “(a) **GENERAL RULE.**—If for any taxable year a tax-  
15 payer other than a corporation has a net capital gain, 50  
16 percent of such gain shall be a deduction from gross  
17 income.

18           “(b) **ESTATES AND TRUSTS.**—In the case of an es-  
19 tate or trust, the deduction shall be computed by excluding  
20 the portion (if any) of the gains for the taxable year from  
21 sales or exchanges of capital assets which, under sections  
22 652 and 662 (relating to inclusions of amounts in gross  
23 income of beneficiaries of trusts), is includible by the in-  
24 come beneficiaries as gain derived from the sale or ex-  
25 change of capital assets.

1       “(c) COORDINATION WITH TREATMENT OF CAPITAL  
2 GAIN UNDER LIMITATION ON INVESTMENT INTEREST.—

3 For purposes of this section, the net capital gain for any  
4 taxable year shall be reduced (but not below zero) by the  
5 amount which the taxpayer takes into account as invest-  
6 ment income under section 163(d)(4)(B)(iii).

7       “(d) TRANSITIONAL RULE.—

8           “(1) IN GENERAL.—In the case of a taxable  
9 year which includes January 1, 1995—

10               “(A) the amount taken into account as the  
11 net capital gain under subsection (a) shall not  
12 exceed the net capital gain determined by only  
13 taking into account gains and losses properly  
14 taken into account for the portion of the tax-  
15 able year on or after January 1, 1995, and

16               “(B) if the net capital gain for such year  
17 exceeds the amount taken into account under  
18 subsection (a), the rate of tax imposed by sec-  
19 tion 1 on such excess shall not exceed 28 per-  
20 cent.

21       “(2) SPECIAL RULES FOR PASS-THRU ENTI-  
22 TIES.—

23           “(A) IN GENERAL.—In applying paragraph  
24 (1) with respect to any pass-thru entity, the de-  
25 termination of when gains and losses are prop-

1           erly taken into account shall be made at the en-  
2           tity level.

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

6                           “(i) a regulated investment company,

7                           “(ii) a real estate investment trust,

8                           “(iii) an S corporation,

9                           “(iv) a partnership,

10                          “(v) an estate or trust, and

11                          “(vi) a common trust fund.”.

12           (b) DEDUCTION ALLOWABLE IN COMPUTING AD-  
13 JUSTED GROSS INCOME.—Subsection (a) of section 62 is  
14 amended by inserting after paragraph (15) the following  
15 new paragraph:

16                   “(16) LONG-TERM CAPITAL GAINS.—The de-  
17           duction allowed by section 1202.”.

18           (c) TECHNICAL AND CONFORMING CHANGES.—

19                   (1) Section 1 is amended by striking subsection  
20           (h).

21                   (2) Paragraph (1) of section 170(e) is amended  
22           by striking “the amount of gain” in the material fol-  
23           lowing subparagraph (B)(ii) and inserting “50 per-  
24           cent (<sup>25</sup>/<sub>35</sub> in the case of a corporation) of the  
25           amount of gain”.

1           (3) Subparagraph (B) of section 172(d)(2) is  
2 amended to read as follows:

3           “(B) the deduction under section 1202 and  
4 the exclusion under section 1203 shall not be  
5 allowed.”.

6           (4) The last sentence of section 453A(c)(3) is  
7 amended by striking all that follows “long-term cap-  
8 ital gain,” and inserting “the maximum rate on net  
9 capital gain under section 1201 or the deduction  
10 under section 1202 (whichever is appropriate) shall  
11 be taken into account.”.

12           (5) Paragraph (4) of section 642(c) is amended  
13 to read as follows:

14           “(4) ADJUSTMENTS.—To the extent that the  
15 amount otherwise allowable as a deduction under  
16 this subsection consists of gain from the sale or ex-  
17 change of capital assets held for more than 1 year  
18 or gain described in section 1203(a), proper adjust-  
19 ment shall be made for any deduction allowable to  
20 the estate or trust under section 1202 (relating to  
21 deduction for excess of capital gains over capital  
22 losses) or for the exclusion allowable to the estate or  
23 trust under section 1203 (relating to exclusion for  
24 gain from certain small business stock). In the case  
25 of a trust, the deduction allowed by this subsection

1 shall be subject to section 681 (relating to unrelated  
2 business income).”.

3 (6) The last sentence of section 643(a)(3) is  
4 amended to read as follows: “The deduction under  
5 section 1202 (relating to deduction of excess of cap-  
6 ital gains over capital losses) and the exclusion  
7 under section 1203 (relating to exclusion for gain  
8 from certain small business stock) shall not be taken  
9 into account.”.

10 (7) Subparagraph (C) of section 643(a)(6) is  
11 amended by inserting “(i)” before “there shall” and  
12 by inserting before the period “, and (ii) the deduc-  
13 tion under section 1202 (relating to capital gains de-  
14 duction) and the exclusion under section 1203 (re-  
15 lating to exclusion for gain from certain small busi-  
16 ness stock) shall not be taken into account”.

17 (8) Paragraph (4) of section 691(c) is amended  
18 by striking “sections 1(h), 1201, 1202, and 1211”  
19 and inserting “sections 1201, 1202, 1203, and  
20 1211”.

21 (9) The second sentence of section 871(a)(2) is  
22 amended by inserting “or 1203” after “section  
23 1202”.

24 (10)(A) Paragraph (2) of section 904(b) is  
25 amended by striking subparagraph (A), by redesignig-

1 nating subparagraph (B) as subparagraph (A), and  
2 by inserting after subparagraph (A) (as so redesign-  
3 nated) the following new subparagraph:

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

10 (B) Subparagraph (A) of section 904(b)(2), as  
11 so redesignated, is amended—

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

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

16 (ii) by striking in clause (i) “in lieu of ap-  
17 plying subparagraph (A),”.

18 (C) Paragraph (3) of section 904(b) is amended  
19 by striking subparagraphs (D) and (E) and inserting  
20 the following new subparagraph:

21 “(D) RATE DIFFERENTIAL PORTION.—The  
22 rate differential portion of foreign source net  
23 capital gain, net capital gain, or the excess of  
24 net capital gain from sources within the United  
25 States over net capital gain, as the case may

1 be, is the same proportion of such amount as  
2 the excess of the highest rate of tax specified in  
3 section 11(b) over the alternative rate of tax  
4 under section 1201(a) bears to the highest rate  
5 of tax specified in section 11(b).”.

6 (D) Clause (v) of section 593(b)(2)(D) is  
7 amended—

8 (i) by striking “if there is a capital gain  
9 rate differential (as defined in section  
10 904(b)(3)(D)) for the taxable year,”, and

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

13 (11) The last sentence of section 1044(d) is  
14 amended by striking “1202” and inserting “1203”.

15 (12)(A) Paragraph (2) of section 1211(b) is  
16 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) as precedes subparagraph (B) thereof is  
25 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.—In the case of any  
6                   amount which, under this subsection and section  
7                   1211(b) (as in effect for taxable years beginning be-  
8                   fore January 1, 1996), is treated as a capital loss  
9                   in the first taxable year beginning after December  
10                  31, 1995, paragraph (2) and section 1211(b) (as so  
11                  in effect) shall apply (and paragraph (2) and section  
12                  1211(b) as in effect for taxable years beginning  
13                  after December 31, 1995, shall not apply) to the ex-  
14                  tent such amount exceeds the total of any capital  
15                  gain net income (determined without regard to this  
16                  subsection) for taxable years beginning after Decem-  
17                  ber 31, 1995.”.

18                  (13) Paragraph (1) of section 1402(i) is amend-  
19                  ed by inserting “, and the deduction provided by sec-  
20                  tion 1202 and the exclusion provided by section  
21                  1203 shall not apply” before the period at the end  
22                  thereof.

23                  (14) Subsection (e) of section 1445 is amend-  
24                  ed—

1 (A) in paragraph (1) by striking “35 per-  
2 cent (or, to the extent provided in regulations,  
3 28 percent)” and inserting “25 percent (or, to  
4 the extent provided in regulations, 19.8 per-  
5 cent)”, and

6 (B) in paragraph (2) by striking “35 per-  
7 cent” and inserting “25 percent”.

8 (15)(A) The second sentence of section  
9 7518(g)(6)(A) is amended—

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

12 (ii) by striking “28 percent (34 percent”  
13 and inserting “19.8 percent (25 percent”.

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

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

20 (ii) by striking “28 percent (34 percent”  
21 and inserting “19.8 percent (25 percent”.

22 (d) CLERICAL AMENDMENT.—The table of sections  
23 for part I of subchapter P of chapter 1 is amended by  
24 striking the item relating to section 1202 and by inserting

1 after the item relating to section 1201 the following new  
2 items:

“Sec. 1202. Capital gains deduction.

“Sec. 1203. 50-percent exclusion for gain from certain small  
business stock.”.

3 (e) EFFECTIVE DATE.—

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, 1994.

8 (2) CONTRIBUTIONS.—The amendment made  
9 by subsection (c)(2) shall apply to contributions on  
10 or after January 1, 1995.

11 (3) USE OF LONG-TERM LOSSES.—The amend-  
12 ments made by subsection (c)(12) shall apply to tax-  
13 able years beginning after December 31, 1995.

14 (4) WITHHOLDING.—The amendment made by  
15 subsection (c)(14) shall apply only to amounts paid  
16 after the date of the enactment of this Act.

17 **Subtitle B—Capital Gains**  
18 **Reduction for Corporations**

19 **SEC. 111. REDUCTION OF ALTERNATIVE CAPITAL GAIN TAX**  
20 **FOR CORPORATIONS.**

21 (a) IN GENERAL.—Section 1201 is amended to read  
22 as follows:

1 **“SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.**

2       “(a) GENERAL RULE.—If for any taxable year a cor-  
3 poration has a net capital gain, then, in lieu of the tax  
4 imposed by sections 11, 511, and 831 (a) and (b) (which-  
5 ever is applicable), there is hereby imposed a tax (if such  
6 tax is less than the tax imposed by such sections) which  
7 shall consist of the sum of—

8               “(1) a tax computed on the taxable income re-  
9 duced by the amount of the net capital gain, at the  
10 rates and in the manner as if this subsection had  
11 not been enacted, plus

12               “(2) a tax of 25 percent of the net capital gain.

13       “(b) TRANSITIONAL RULE.—

14               “(1) IN GENERAL.—In the case of any taxable  
15 year ending after December 31, 1994, and beginning  
16 before January 1, 1996, in applying subsection (a),  
17 net capital gain for such taxable year shall not ex-  
18 ceed such net capital gain determined by taking into  
19 account only gain or loss properly taken into account  
20 for the portion of the taxable year after December  
21 31, 1994.

22               “(2) SPECIAL RULE FOR PASS-THRU ENTI-  
23 TIES.—Section 1202(d)(2) shall apply for purposes  
24 of paragraph (1).

1 “(c) CROSS REFERENCES.—

“For computation of the alternative tax—

“(1) in the case of life insurance companies, see section 801(a)(2),

“(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

“(3) in the case of real estate investment trusts, see section 857(b)(3)(A).”.

2 (b) TECHNICAL AMENDMENT.—Clause (iii) of section  
3 852(b)(3)(D) is amended by striking “65 percent” and in-  
4 serting “75 percent”.

5 (c) EFFECTIVE DATE.—The amendments made by  
6 this section shall apply to taxable years ending after De-  
7 cember 31, 1994.

8 **Subtitle C—Capital Loss Deduction**  
9 **Allowed With Respect to Sale or**  
10 **Exchange of Principal Resi-**  
11 **dence**

12 **SEC. 121. CAPITAL LOSS DEDUCTION ALLOWED WITH RE-**  
13 **SPECT TO SALE OR EXCHANGE OF PRINCIPAL**  
14 **RESIDENCE.**

15 (a) IN GENERAL.—Subsection (c) of section 165 (re-  
16 lating to limitation on losses of individuals) is amended  
17 by striking “and” at the end of paragraph (2), by striking  
18 the period at the end of paragraph (3) and inserting “;  
19 and”, and by adding at the end the following new para-  
20 graph:

1           “(4) losses arising from the sale or exchange of  
2           the principal residence (within the meaning of sec-  
3           tion 1034) of the taxpayer.”.

4           (b) EFFECTIVE DATE.—The amendment made by  
5           subsection (a) shall apply to sales and exchanges after De-  
6           cember 31, 1994, in taxable years ending after such date.

7           **TITLE II—SMALL BUSINESS**  
8           **VENTURE CAPITAL STOCK**

9           **SEC. 201. MODIFICATIONS TO EXCLUSION OF GAIN ON CER-**  
10           **TAIN SMALL BUSINESS STOCK.**

11           (a) INCREASE IN EXCLUSION PERCENTAGE.—

12           (1) IN GENERAL.—Section 1203(a), as redesignig-  
13           nated by section 101, is amended—

14           (A) by striking “50 percent” and inserting  
15           “75 percent”, and

16           (B) by striking “50-PERCENT” in the  
17           heading and inserting “Partial”.

18           (2) CONFORMING AMENDMENTS.—

19           (A) Section 1203, as so redesignated, is  
20           amended by adding at the end the following  
21           new subsection:

22           “(l) CROSS REFERENCE.—

**“For treatment of eligible gain not excluded under  
          subsection (a), see sections 1201 and 1202.”.**

1 (B) The heading for section 1203, as so  
2 redesignated, is amended by striking “**50-PER-**  
3 **CENT**” and inserting “**PARTIAL**”.

4 (C) The table of sections for part I of sub-  
5 chapter P of chapter 1, as amended by section  
6 101(d), is amended by striking “50-percent” in  
7 the item relating to section 1203 and inserting  
8 “Partial”.

9 (b) EXCLUSION AVAILABLE TO CORPORATIONS.—

10 (1) IN GENERAL.—Subsection (a) of section  
11 1203, as redesignated by section 101, is amended by  
12 striking “other than a corporation”.

13 (2) TECHNICAL AMENDMENT.—Subsection (c)  
14 of section 1203, as so redesignated, is amended by  
15 adding at the end the following new paragraph:

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

22 (c) REPEAL OF MINIMUM TAX PREFERENCE.—

23 (1) IN GENERAL.—Subsection (a) of section 57  
24 is amended by striking paragraph (7).



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

4           (d) STOCK OF LARGER BUSINESSES ELIGIBLE FOR  
5 EXCLUSION.—

6           (1) Paragraph (1) of section 1203(d), as reded-  
7 igned by section 101, is amended by striking  
8 “\$50,000,000” each place it appears and inserting  
9 “\$100,000,000”.

10           (2) Subsection (d) of section 1203, as so reded-  
11 igned, is amended by adding at the end the follow-  
12 ing new paragraph:

13           “(4) INFLATION ADJUSTMENT OF ASSET LIM-  
14 ITATION.—In the case of stock issued in any calendar  
15 year after 1996, the \$100,000,000 amount con-  
16 tained in paragraph (1) shall be increased by an  
17 amount equal to—

18           “(A) such dollar amount, multiplied by

19           “(B) the cost-of-living adjustment deter-  
20 mined under section 1(f)(3) for the calendar  
21 year in which the taxable year begins, deter-  
22 mined by substituting ‘calendar year 1995’ for  
23 ‘calendar year 1992’ in subparagraph (B)  
24 thereof.

1 If any amount as adjusted under the preceding sen-  
2 tence is not a multiple of \$10,000, such amount  
3 shall be rounded to the nearest multiple of  
4 \$10,000.”.

5 (e) REPEAL OF PER-ISSUER LIMITATION.—Section  
6 1203, as redesignated by section 101, is amended by strik-  
7 ing subsection (b).

8 (f) OTHER MODIFICATIONS.—

9 (1) REPEAL OF WORKING CAPITAL LIMITA-  
10 TION.—Paragraph (6) of section 1203(e), as redesign-  
11 nated by section 101, is amended—

12 (A) by striking “2 years” in subparagraph

13 (B) and inserting “5 years”, and

14 (B) by striking the last sentence.

15 (2) EXCEPTION FROM REDEMPTION RULES  
16 WHERE BUSINESS PURPOSE.—Paragraph (3) of sec-  
17 tion 1203(c), as so redesignated, is amended by add-  
18 ing at the end the following new subparagraph:

19 “(D) WAIVER WHERE BUSINESS PUR-  
20 POSE.—A purchase of stock by the issuing cor-  
21 poration shall be disregarded for purposes of  
22 subparagraph (B) if the issuing corporation es-  
23 tablishes that there was a business purpose for  
24 such purchase and one of the principal purposes

1 of the purchase was not to avoid the limitations  
2 of this section.”.

3 (g) QUALIFIED TRADE OR BUSINESS.—Section  
4 1203(e)(3), as redesignated by section 101, is amended  
5 by inserting “and” at the end of subparagraph (C), by  
6 striking “, and” at the end of subparagraph (D) and in-  
7 serting a period, and by striking subparagraph (E).

8 (h) EFFECTIVE DATES.—

9 (1) IN GENERAL.—Except as provided in para-  
10 graph (2), the amendments made by this section  
11 shall apply to stock issued after the date of the en-  
12 actment of this Act.

13 (2) SPECIAL RULE.—The amendments made by  
14 subsections (a), (c), (e), and (f) shall apply to stock  
15 issued after August 10, 1993.

16 **SEC. 202. ROLLOVER OF GAIN FROM SALE OF QUALIFIED**  
17 **STOCK.**

18 (a) IN GENERAL.—Part III of subchapter O of chap-  
19 ter 1 is amended by adding at the end the following new  
20 section:

21 **“SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL**  
22 **BUSINESS STOCK TO ANOTHER QUALIFIED**  
23 **SMALL BUSINESS STOCK.**

24 “(a) NONRECOGNITION OF GAIN.—In the case of any  
25 sale of qualified small business stock with respect to which

1 the taxpayer elects the application of this section, eligible  
2 gain from such sale shall be recognized only to the extent  
3 that the amount realized on such sale exceeds—

4 “(1) the cost of any qualified small business  
5 stock purchased by the taxpayer during the 60-day  
6 period beginning on the date of such sale, reduced  
7 by

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

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

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

14 “(1) QUALIFIED SMALL BUSINESS STOCK.—The  
15 term ‘qualified small business stock’ has the mean-  
16 ing given such term by section 1203(c).

17 “(2) ELIGIBLE GAIN.—The term ‘eligible gain’  
18 means any gain from the sale or exchange of quali-  
19 fied small business stock held for more than 5 years.

20 “(3) PURCHASE.—A taxpayer shall be treated  
21 as having purchased any property if, but for para-  
22 graph (4), the unadjusted basis of such property in  
23 the hands of the taxpayer would be its cost (within  
24 the meaning of section 1012).”

1           “(4) BASIS ADJUSTMENTS.—If gain from any  
2           sale is not recognized by reason of subsection (a),  
3           such gain shall be applied to reduce (in the order ac-  
4           quired) the basis for determining gain or loss of any  
5           qualified small business stock which is purchased by  
6           the taxpayer during the 60-day period described in  
7           subsection (a).

8           “(c) SPECIAL RULES FOR TREATMENT OF REPLACE-  
9           MENT STOCK.—

10           “(1) HOLDING PERIOD FOR ACCRUED GAIN.—  
11           For purposes of this chapter, gain from the disposi-  
12           tion of any replacement qualified small business  
13           stock shall be treated as gain from the sale or ex-  
14           change of qualified small business stock held more  
15           than 5 years to the extent that the amount of such  
16           gain does not exceed the amount of the reduction in  
17           the basis of such stock by reason of subsection  
18           (b)(4).

19           “(2) TACKING OF HOLDING PERIOD FOR PUR-  
20           POSES OF DEFERRAL.—Solely for purposes of apply-  
21           ing this section, if any replacement qualified small  
22           business stock is disposed of before the taxpayer has  
23           held such stock for more than 5 years, gain from  
24           such stock shall be treated eligible gain for purposes  
25           of subsection (a).

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

6           (b) CONFORMING AMENDMENTS.—

7           (1) Section 1016(a)(23) is amended—

8                   (A) by striking “or 1044” and inserting “,  
9                   1044, or 1045”, and

10                   (B) by striking “or 1044(d)” and inserting  
11                   “, 1044(d), or 1045(b)(4)”.

12           (2) The table of sections for part III of sub-  
13           chapter O of chapter 1 is amended by adding at the  
14           end the following new item:

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

15           (c) EFFECTIVE DATE.—The amendments made by  
16           this section shall apply to stock sold or exchanged after  
17           the date of the enactment of this Act.

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