

105TH CONGRESS
2D SESSION

S. 1635

To amend the Internal Revenue Code of 1986 to reduce the maximum capital gains rates, to index capital assets for inflation, and to repeal the Federal estate and gift taxes and the tax on generation-skipping transfers.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 12, 1998

Mr. ALLARD 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 reduce the maximum capital gains rates, to index capital assets for inflation, and to repeal the Federal estate and gift taxes and the tax on generation-skipping transfers.

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. REDUCTION OF MAXIMUM CAPITAL GAINS**
4 **RATES.**

5 (a) TAXPAYERS OTHER THAN CORPORATIONS.—Sec-
6 tion 1(h) of the Internal Revenue Code of 1986 (relating
7 to maximum capital gains rate) is amended to read as fol-
8 lows:

1 “(h) MAXIMUM CAPITAL GAINS RATE.—

2 “(1) IN GENERAL.—If a taxpayer has a net
3 capital gain for any taxable year, the tax imposed by
4 this section for such taxable year shall not exceed
5 the sum of—

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

10 “(B) 7 percent of so much of the tax-
11 payer’s net capital gain (or, if less, taxable in-
12 come) as does not exceed the excess (if any)
13 of—

14 “(i) the amount of taxable income
15 which would (without regard to this para-
16 graph) be taxed at a rate below 28 per-
17 cent, over

18 “(ii) the taxable income reduced by
19 the net capital gain, plus

20 “(C) 14 percent of the amount of taxable
21 income in excess of the sum of the amounts on
22 which a tax is determined under subparagraphs
23 (A) and (B).

24 “(2) INVESTMENT INCOME.—For purposes of
25 this subsection, the net capital gain for any taxable

1 year shall be reduced (but not below zero) by the
 2 amount which the taxpayer elects to take into ac-
 3 count as investment income for the taxable year
 4 under section 163(d)(4)(B)(iii).”.

5 (b) REDUCTION OF ALTERNATIVE CAPITAL GAIN
 6 TAX FOR CORPORATIONS.—Section 1201 of the Internal
 7 Revenue Code of 1986 (relating to alternative tax for cor-
 8 porations) is amended to read as follows:

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

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

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

20 “(2) a tax of 14 percent of the net capital gain
 21 (or, if less, taxable income).

22 “(b) TRANSITIONAL RULE.—

23 “(1) IN GENERAL.—In the case of a taxable
 24 year which includes January 1, 1999, the amount
 25 taken into account as the net capital gain under

1 subsection (a) shall not exceed the net capital gain
 2 determined by only taking into account gains and
 3 losses properly taken into account for the portion of
 4 the taxable year after December 31, 1998.

5 “(2) SPECIAL RULES FOR PASS-THRU ENTI-
 6 TIES.—

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

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

15 “(i) a regulated investment company,

16 “(ii) a real estate investment trust,

17 “(iii) an S corporation,

18 “(iv) a partnership,

19 “(v) an estate or trust, and

20 “(vi) a common trust fund.

21 “(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).”

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years ending after De-
3 cember 31, 1998.

4 **SEC. 2. INDEXING OF CERTAIN ASSETS FOR PURPOSES OF**
5 **DETERMINING GAIN OR LOSS.**

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

10 **“SEC. 1022. INDEXING OF CERTAIN ASSETS FOR PURPOSES**
11 **OF DETERMINING GAIN OR LOSS.**

12 “(a) GENERAL RULE.—

13 “(1) INDEXED BASIS SUBSTITUTED FOR AD-
14 JUSTED BASIS.—Except as provided in paragraph
15 (2), if an indexed asset which has been held for
16 more than 1 year is sold or otherwise disposed of,
17 then, for purposes of this title, the indexed basis of
18 the asset shall be substituted for its adjusted basis.

19 “(2) EXCEPTION FOR DEPRECIATION, ETC.—
20 The deduction for depreciation, depletion, and amor-
21 tization shall be determined without regard to the
22 application of paragraph (1) to the taxpayer or any
23 other person.

24 “(b) INDEXED ASSET.—

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

3 “(A) stock in a corporation, and

4 “(B) tangible property (or any interest
5 therein), which is a capital asset or property
6 used in the trade or business (as defined in sec-
7 tion 1231(b)).

8 “(2) CERTAIN PROPERTY EXCLUDED.—For
9 purposes of this section, the term ‘indexed asset’
10 does not include—

11 “(A) CREDITOR’S INTEREST.—Any interest
12 in property which is in the nature of a credi-
13 tor’s interest.

14 “(B) OPTIONS.—Any option or other right
15 to acquire an interest in property.

16 “(C) NET LEASE PROPERTY.—In the case
17 of a lessor, net lease property (within the mean-
18 ing of subsection (h)(1)).

19 “(D) CERTAIN PREFERRED STOCK.—Stock
20 which is preferred as to dividends and does not
21 participate in corporate growth to any signifi-
22 cant extent.

23 “(E) STOCK IN CERTAIN CORPORATIONS.—
24 Stock in—

1 “(i) an S corporation (within the
2 meaning of section 1361),

3 “(ii) a personal holding company (as
4 defined in section 542), and

5 “(iii) a foreign corporation.

6 “(3) EXCEPTION FOR STOCK IN FOREIGN COR-
7 PORATION WHICH IS REGULARLY TRADED ON NA-
8 TIONAL OR REGIONAL EXCHANGE.—Clause (iii) of
9 paragraph (2)(E) shall not apply to stock in a for-
10 eign corporation the stock of which is listed on the
11 New York Stock Exchange, the American Stock Ex-
12 change, or any domestic regional exchange for which
13 quotations are published on a regular basis other
14 than—

15 “(A) stock of a foreign investment com-
16 pany (within the meaning of section 1246(b)),
17 and

18 “(B) stock in a foreign corporation held by
19 a United States person who meets the require-
20 ments of section 1248(a)(2).

21 “(c) INDEXED BASIS.—For purposes of this sec-
22 tion—

23 “(1) GENERAL RULE.—The indexed basis for
24 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 chain-type price index for
11 GDP for the last calendar quarter ending
12 before the asset is disposed of, exceeds

13 “(ii) the chain-type price index for
14 GDP for the last calendar quarter ending
15 before the asset was acquired by the tax-
16 payer.

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

19 “(3) CHAIN-TYPE PRICE INDEX FOR GDP.—
20 The chain-type price index for GDP for any calendar
21 quarter is such index for such quarter (as shown in
22 the last revision thereof released by the Secretary of
23 Commerce before the close of the following calendar
24 quarter).

1 “(d) SPECIAL RULES.—For purposes of this sec-
2 tion—

3 “(1) TREATMENT AS SEPARATE ASSET.—In the
4 case of any asset, the following shall be treated as
5 a separate asset:

6 “(A) a substantial improvement to prop-
7 erty,

8 “(B) in the case of stock of a corporation,
9 a substantial contribution to capital, and

10 “(C) any other portion of an asset to the
11 extent that separate treatment of such portion
12 is appropriate to carry out the purposes of this
13 section.

14 “(2) ASSETS WHICH ARE NOT INDEXED ASSETS
15 THROUGHOUT HOLDING PERIOD.—

16 “(A) IN GENERAL.—The applicable infla-
17 tion ratio shall be appropriately reduced for cal-
18 endar months at any time during which the
19 asset was not an indexed asset.

20 “(B) CERTAIN SHORT SALES.—For pur-
21 poses of applying subparagraph (A), an asset
22 shall be treated as not an indexed asset for any
23 short sale period during which the taxpayer or
24 the taxpayer’s spouse sells short property sub-
25 stantially identical to the asset. For purposes of

1 the preceding sentence, the short sale period be-
2 gins on the day after the substantially identical
3 property is sold and ends on the closing date
4 for the sale.

5 “(3) TREATMENT OF CERTAIN DISTRIBUTIONS.—A distribution with respect to stock in a
6 corporation which is not a dividend shall be treated
7 as a disposition.
8

9 “(4) SECTION CANNOT INCREASE ORDINARY
10 LOSS.—To the extent that (but for this paragraph)
11 this section would create or increase a net ordinary
12 loss to which section 1231(a)(2) applies or an ordi-
13 nary loss to which any other provision of this title
14 applies, such provision shall not apply. The taxpayer
15 shall be treated as having a long-term capital loss in
16 an amount equal to the amount of the ordinary loss
17 to which the preceding sentence applies.

18 “(5) ACQUISITION DATE WHERE THERE HAS
19 BEEN PRIOR APPLICATION OF SUBSECTION (a)(1)
20 WITH RESPECT TO THE TAXPAYER.—If there has
21 been a prior application of subsection (a)(1) to an
22 asset while such asset was held by the taxpayer, the
23 date of acquisition of such asset by the taxpayer
24 shall be treated as not earlier than the date of the
25 most recent such prior application.

1 “(6) COLLAPSIBLE CORPORATIONS.—The appli-
2 cation of section 341(a) (relating to collapsible cor-
3 porations) shall be determined without regard to this
4 section.

5 “(e) CERTAIN CONDUIT ENTITIES.—

6 “(1) REGULATED INVESTMENT COMPANIES;
7 REAL ESTATE INVESTMENT TRUSTS; COMMON TRUST
8 FUNDS.—

9 “(A) IN GENERAL.—Stock in a qualified
10 investment entity shall be an indexed asset for
11 any calendar month in the same ratio as the
12 fair market value of the assets held by such en-
13 tity at the close of such month which are in-
14 dexed assets bears to the fair market value of
15 all assets of such entity at the close of such
16 month.

17 “(B) RATIO OF 90 PERCENT OR MORE.—If
18 the ratio for any calendar month determined
19 under subparagraph (A) would (but for this
20 subparagraph) be 90 percent or more, such
21 ratio for such month shall be 100 percent.

22 “(C) RATIO OF 10 PERCENT OR LESS.—If
23 the ratio for any calendar month determined
24 under subparagraph (A) would (but for this

1 subparagraph) be 10 percent or less, such ratio
2 for such month shall be zero.

3 “(D) VALUATION OF ASSETS IN CASE OF
4 REAL ESTATE INVESTMENT TRUSTS.—Nothing
5 in this paragraph shall require a real estate in-
6 vestment trust to value its assets more fre-
7 quently than once each 36 months (except
8 where such trust ceases to exist). The ratio
9 under subparagraph (A) for any calendar
10 month for which there is no valuation shall be
11 the trustee’s good faith judgment as to such
12 valuation.

13 “(E) QUALIFIED INVESTMENT ENTITY.—
14 For purposes of this paragraph, the term
15 ‘qualified investment entity’ means—

16 “(i) a regulated investment company
17 (within the meaning of section 851),

18 “(ii) a real estate investment trust
19 (within the meaning of section 856), and

20 “(iii) a common trust fund (within the
21 meaning of section 584).

22 “(2) PARTNERSHIPS.—In the case of a partner-
23 ship, the adjustment made under subsection (a) at
24 the partnership level shall be passed through to the
25 partners.

1 “(3) SUBCHAPTER S CORPORATIONS.—In the
2 case of an electing small business corporation, the
3 adjustment under subsection (a) at the corporate
4 level shall be passed through to the shareholders.

5 “(f) DISPOSITIONS BETWEEN RELATED PERSONS.—

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

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

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

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

18 “(g) TRANSFERS TO INCREASE INDEXING ADJUST-
19 MENT OR DEPRECIATION ALLOWANCE.—If any person
20 transfers cash, debt, or any other property to another per-
21 son and the principal purpose of such transfer is—

22 “(1) to secure or increase an adjustment under
23 subsection (a), or

1 “(2) to increase (by reason of an adjustment
2 under subsection (a)) a deduction for depreciation,
3 depletion, or amortization,
4 the Secretary may disallow part or all of such adjustment
5 or increase.

6 “(h) DEFINITIONS.—For purposes of this section—

7 “(1) NET LEASE PROPERTY DEFINED.—The
8 term ‘net lease property’ means leased real property
9 where—

10 “(A) the term of the lease (taking into ac-
11 count options to renew) was 50 percent or more
12 of the useful life of the property, and

13 “(B) for the period of the lease, the sum
14 of the deductions with respect to such property
15 which are allowable to the lessor solely by rea-
16 son of section 162 (other than rents and reim-
17 bursed amounts with respect to such property)
18 is 15 percent or less of the rental income pro-
19 duced by such property.

20 “(2) STOCK INCLUDES INTEREST IN COMMON
21 TRUST FUND.—The term ‘stock in a corporation’ in-
22 cludes any interest in a common trust fund (as de-
23 fined in section 584(a)).

1 “(i) REGULATIONS.—The Secretary shall prescribe
2 such regulations as may be necessary or appropriate to
3 carry out the purposes of this section.”

4 (b) CLERICAL AMENDMENT.—The table of sections
5 for part II of subchapter O of such chapter 1 of the Inter-
6 nal Revenue Code of 1986 is amended by inserting after
7 the item relating to section 1021 the following new item:

“Sec. 1022. Indexing of certain assets for purposes of determining
gain or loss.”

8 (c) ADJUSTMENT TO APPLY FOR PURPOSES OF DE-
9 TERMINING EARNINGS AND PROFITS.—Subsection (f) of
10 section 312 of the Internal Revenue Code of 1986 (relat-
11 ing to effect on earnings and profits of gain or loss and
12 of receipt of tax-free distributions) is amended by adding
13 at the end thereof the following new paragraph:

14 “(3) EFFECT ON EARNINGS AND PROFITS OF
15 INDEXED BASIS.—

**“For substitution of indexed basis for adjusted
basis in the case of the disposition of certain assets
after December 31, 1998, see section 1022(a)(1).”**

16 (d) EFFECTIVE DATES.—

17 (1) IN GENERAL.—The amendments made by
18 this section shall apply to the disposition of any
19 property the holding period of which begins after
20 December 31, 1998.

21 (2) CERTAIN TRANSACTIONS BETWEEN RELAT-
22 ED PERSONS.—The amendments made by this sec-

1 tion shall not apply to the disposition of any prop-
2 erty acquired after December 31, 1998, from a re-
3 lated person (as defined in section 1022(f)(2) of the
4 Internal Revenue Code of 1986, as added by this
5 section) if—

6 (A) such property was so acquired for a
7 price less than the property's fair market value,
8 and

9 (B) the amendments made by this section
10 did not apply to such property in the hands of
11 such related person.

12 **SEC. 3. REPEAL OF CERTAIN FEDERAL TRANSFER TAXES.**

13 (a) **IN GENERAL.**—Subtitle B of the Internal Reve-
14 nue Code of 1986 is repealed.

15 (b) **EFFECTIVE DATE.**—The repeal made by sub-
16 section (a) shall apply to the estates of decedents dying,
17 and gifts and generation-skipping transfers made, after
18 the date of enactment of this Act.

19 (c) **TECHNICAL AND CONFORMING CHANGES.**—The
20 Secretary of the Treasury or the Secretary's delegate
21 shall, as soon as practicable but in any event not later
22 than 90 days after the date of enactment of this Act, sub-
23 mit to the Committee on Ways and Means of the House
24 of Representatives and the Committee on Finance of the
25 Senate a draft of any technical and conforming changes

1 in the Internal Revenue Code of 1986 which are necessary
2 to reflect throughout such Code the changes in the sub-
3 stantive provisions of law made by this Act.

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