

107TH CONGRESS  
1ST SESSION

# H. R. 3071

To amend the Internal Revenue Code of 1986 to index the basis of assets acquired after December 31, 2001, for purposes of determining gain.

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## IN THE HOUSE OF REPRESENTATIVES

OCTOBER 9, 2001

Mr. SMITH of Michigan 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 index the basis of assets acquired after December 31, 2001, for purposes of determining gain.

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 Tax  
5 Fairness Act of 2001”.

6 **SEC. 2. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER**  
7 **DECEMBER 31, 2000, FOR PURPOSES OF DE-**  
8 **TERMINING GAIN.**

9 (a) IN GENERAL.—Part II of subchapter O of chap-  
10 ter 1 of the Internal Revenue Code of 1986 (relating to

1 basis rules of general application) is amended by inserting  
2 after section 1022 the following new section:

3 **“SEC. 1023. INDEXING OF CERTAIN ASSETS ACQUIRED**  
4 **AFTER DECEMBER 31, 2001, FOR PURPOSES**  
5 **OF DETERMINING GAIN.**

6 “(a) GENERAL RULE.—

7 “(1) INDEXED BASIS SUBSTITUTED FOR AD-  
8 JUSTED BASIS.—Solely for purposes of determining  
9 gain on the sale or other disposition by a taxpayer  
10 (other than a corporation) of an indexed asset which  
11 has been held for more than 3 years, the indexed  
12 basis of the asset shall be substituted for its ad-  
13 justed basis.

14 “(2) EXCEPTION FOR DEPRECIATION, ETC.—  
15 The deductions for depreciation, depletion, and am-  
16 ortization shall be determined without regard to the  
17 application of paragraph (1) to the taxpayer or any  
18 other person.

19 “(3) EXCEPTION FOR PRINCIPAL RESI-  
20 DENCES.—Paragraph (1) shall not apply to any dis-  
21 position of the principal residence (within the mean-  
22 ing of section 121) of the taxpayer .

23 “(b) INDEXED ASSET.—

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

1           “(A) common stock in a C corporation  
2           (other than a foreign corporation), and

3           “(B) tangible property,  
4           which is a capital asset or property used in the trade  
5           or business (as defined in section 1231(b)).

6           “(2) STOCK IN CERTAIN FOREIGN CORPORA-  
7           TIONS INCLUDED.—For purposes of this section—

8           “(A) IN GENERAL.—The term ‘indexed  
9           asset’ includes common stock in a foreign cor-  
10          poration which is regularly traded on an estab-  
11          lished securities market.

12          “(B) EXCEPTION.—Subparagraph (A)  
13          shall not apply to—

14               “(i) stock of a foreign investment  
15               company (within the meaning of section  
16               1246(b)),

17               “(ii) stock in a passive foreign invest-  
18               ment company (as defined in section  
19               1296),

20               “(iii) stock in a foreign corporation  
21               held by a United States person who meets  
22               the requirements of section 1248(a)(2),  
23               and

24               “(iv) stock in a foreign personal hold-  
25               ing company (as defined in section 552).

1           “(C) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS.—An American depository receipt for common stock in a foreign corporation shall be treated as common stock in such corporation.

6           “(c) INDEXED BASIS.—For purposes of this section—

8           “(1) GENERAL RULE.—The indexed basis for any asset is—

10           “(A) the adjusted basis of the asset, increased by

12           “(B) the applicable inflation adjustment.

13           “(2) APPLICABLE INFLATION ADJUSTMENT.—The applicable inflation adjustment for any asset is an amount equal to—

16           “(A) the adjusted basis of the asset, multiplied by

18           “(B) the percentage (if any) by which—

20           “(i) the chain-type price index for GDP for the last calendar quarter ending before the asset is disposed of, exceeds

22           “(ii) the chain-type price index for GDP for the last calendar quarter ending before the asset was acquired by the taxpayer.

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

3 “(3) CHAIN-TYPE PRICE INDEX FOR GDP.—The  
4 chain-type price index for GDP for any calendar  
5 quarter is such index for such quarter (as shown in  
6 the last revision thereof released by the Secretary of  
7 Commerce before the close of the following calendar  
8 quarter).

9 “(d) SUSPENSION OF HOLDING PERIOD WHERE DI-  
10 MINISHED RISK OF LOSS; TREATMENT OF SHORT  
11 SALES.—

12 “(1) IN GENERAL.—If the taxpayer (or a re-  
13 lated person) enters into any transaction which sub-  
14 stantially reduces the risk of loss from holding any  
15 asset, such asset shall not be treated as an indexed  
16 asset for the period of such reduced risk.

17 “(2) SHORT SALES.—

18 “(A) IN GENERAL.—In the case of a short  
19 sale of an indexed asset with a short sale period  
20 in excess of 3 years, for purposes of this title,  
21 the amount realized shall be an amount equal  
22 to the amount realized (determined without re-  
23 gard to this paragraph) increased by the appli-  
24 cable inflation adjustment. In applying sub-  
25 section (c)(2) for purposes of the preceding sen-

1           tence, the date on which the property is sold  
2           short shall be treated as the date of acquisition  
3           and the closing date for the sale shall be treat-  
4           ed as the date of disposition.

5           “(B) SHORT SALE PERIOD.—For purposes  
6           of subparagraph (A), the short sale period be-  
7           gins on the day that the property is sold and  
8           ends on the closing date for the sale.

9           “(e) TREATMENT OF REGULATED INVESTMENT  
10          COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

11           “(1) ADJUSTMENTS AT ENTITY LEVEL.—

12           “(A) IN GENERAL.—Except as otherwise  
13           provided in this paragraph, the adjustment  
14           under subsection (a) shall be allowed to any  
15           qualified investment entity (including for pur-  
16           poses of determining the earnings and profits of  
17           such entity).

18           “(B) EXCEPTION FOR CORPORATE SHARE-  
19           HOLDERS.—Under regulations—

20           “(i) in the case of a distribution by a  
21           qualified investment entity (directly or in-  
22           directly) to a corporation—

23           “(I) the determination of whether  
24           such distribution is a dividend shall be

1 made without regard to this section,  
2 and

3 “(II) the amount treated as gain  
4 by reason of the receipt of any capital  
5 gain dividend shall be increased by the  
6 percentage by which the entity’s net  
7 capital gain for the taxable year (de-  
8 termined without regard to this sec-  
9 tion) exceeds the entity’s net capital  
10 gain for such year determined with re-  
11 gard to this section, and

12 “(ii) there shall be other appropriate  
13 adjustments (including deemed distribu-  
14 tions) so as to ensure that the benefits of  
15 this section are not allowed (directly or in-  
16 directly) to corporate shareholders of quali-  
17 fied investment entities.

18 For purposes of the preceding sentence, any  
19 amount includible in gross income under section  
20 852(b)(3)(D) shall be treated as a capital gain  
21 dividend and an S corporation shall not be  
22 treated as a corporation.

23 “(C) EXCEPTION FOR QUALIFICATION  
24 PURPOSES.—This section shall not apply for  
25 purposes of sections 851(b) and 856(e).

1           “(D) EXCEPTION FOR CERTAIN TAXES IM-  
2           POSED AT ENTITY LEVEL.—

3           “(i) TAX ON FAILURE TO DISTRIBUTE  
4           ENTIRE GAIN.—If any amount is subject to  
5           tax under section 852(b)(3)(A) for any  
6           taxable year, the amount on which tax is  
7           imposed under such section shall be in-  
8           creased by the percentage determined  
9           under subparagraph (B)(i)(II). A similar  
10          rule shall apply in the case of any amount  
11          subject to tax under paragraph (2) or (3)  
12          of section 857(b) to the extent attributable  
13          to the excess of the net capital gain over  
14          the deduction for dividends paid deter-  
15          mined with reference to capital gain divi-  
16          dends only. The first sentence of this  
17          clause shall not apply to so much of the  
18          amount subject to tax under section  
19          852(b)(3)(A) as is designated by the com-  
20          pany under section 852(b)(3)(D).

21          “(ii) OTHER TAXES.—This section  
22          shall not apply for purposes of determining  
23          the amount of any tax imposed by para-  
24          graph (4), (5), or (6) of section 857(b).

1           “(2) ADJUSTMENTS TO INTERESTS HELD IN  
2 ENTITY.—

3           “(A) REGULATED INVESTMENT COMPA-  
4 NIES.—Stock in a regulated investment com-  
5 pany (within the meaning of section 851) shall  
6 be an indexed asset for any calendar quarter in  
7 the same ratio as—

8                   “(i) the average of the fair market  
9 values of the indexed assets held by such  
10 company at the close of each month during  
11 such quarter, bears to

12                   “(ii) the average of the fair market  
13 values of all assets held by such company  
14 at the close of each such month.

15           “(B) REAL ESTATE INVESTMENT  
16 TRUSTS.—Stock in a real estate investment  
17 trust (within the meaning of section 856) shall  
18 be an indexed asset for any calendar quarter in  
19 the same ratio as—

20                   “(i) the fair market value of the in-  
21 dexed assets held by such trust at the close  
22 of such quarter, bears to

23                   “(ii) the fair market value of all as-  
24 sets held by such trust at the close of such  
25 quarter.

1           “(C) RATIO OF 80 PERCENT OR MORE.—If  
2           the ratio for any calendar quarter determined  
3           under subparagraph (A) or (B) would (but for  
4           this subparagraph) be 80 percent or more, such  
5           ratio for such quarter shall be 100 percent.

6           “(D) RATIO OF 20 PERCENT OR LESS.—If  
7           the ratio for any calendar quarter determined  
8           under subparagraph (A) or (B) would (but for  
9           this subparagraph) be 20 percent or less, such  
10          ratio for such quarter shall be zero.

11          “(E) LOOK-THRU OF PARTNERSHIPS.—For  
12          purposes of this paragraph, a qualified invest-  
13          ment entity which holds a partnership interest  
14          shall be treated (in lieu of holding a partnership  
15          interest) as holding its proportionate share of  
16          the assets held by the partnership.

17          “(3) TREATMENT OF RETURN OF CAPITAL DIS-  
18          TRIBUTIONS.—Except as otherwise provided by the  
19          Secretary, a distribution with respect to stock in a  
20          qualified investment entity which is not a dividend  
21          and which results in a reduction in the adjusted  
22          basis of such stock shall be treated as allocable to  
23          stock acquired by the taxpayer in the order in which  
24          such stock was acquired.

1           “(4) QUALIFIED INVESTMENT ENTITY.—For  
2 purposes of this subsection, the term ‘qualified in-  
3 vestment entity’ means—

4           “(A) a regulated investment company  
5 (within the meaning of section 851), and

6           “(B) a real estate investment trust (within  
7 the meaning of section 856).

8           “(f) OTHER PASS-THRU ENTITIES.—

9           “(1) PARTNERSHIPS.—

10           “(A) IN GENERAL.—In the case of a part-  
11 nership, the adjustment made under subsection  
12 (a) at the partnership level shall be passed  
13 through to the partners.

14           “(B) SPECIAL RULE IN THE CASE OF SEC-  
15 TION 754 ELECTIONS.—In the case of a transfer  
16 of an interest in a partnership with respect to  
17 which the election provided in section 754 is in  
18 effect—

19           “(i) the adjustment under section  
20 743(b)(1) shall, with respect to the trans-  
21 feror partner, be treated as a sale of the  
22 partnership assets for purposes of applying  
23 this section, and

24           “(ii) with respect to the transferee  
25 partner, the partnership’s holding period

1           for purposes of this section in such assets  
2           shall be treated as beginning on the date  
3           of such adjustment.

4           “(2) S CORPORATIONS.—In the case of an S  
5           corporation, the adjustment made under subsection  
6           (a) at the corporate level shall be passed through to  
7           the shareholders. This section shall not apply for  
8           purposes of determining the amount of any tax im-  
9           posed by section 1374 or 1375.

10          “(3) COMMON TRUST FUNDS.—In the case of a  
11          common trust fund, the adjustment made under sub-  
12          section (a) at the trust level shall be passed through  
13          to the participants.

14          “(4) INDEXING ADJUSTMENT DISREGARDED IN  
15          DETERMINING LOSS ON SALE OF INTEREST IN ENTI-  
16          TY.—Notwithstanding the preceding provisions of  
17          this subsection, for purposes of determining the  
18          amount of any loss on a sale or exchange of an in-  
19          terest in a partnership, S corporation, or common  
20          trust fund, the adjustment made under subsection  
21          (a) shall not be taken into account in determining  
22          the adjusted basis of such interest.

23          “(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

24                 “(1) IN GENERAL.—This section shall not apply  
25                 to any sale or other disposition of property between

1 related persons except to the extent that the basis  
2 of such property in the hands of the transferee is a  
3 substituted basis.

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

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

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

11 “(h) TRANSFERS TO INCREASE INDEXING ADJUST-  
12 MENT.—If any person transfers cash, debt, or any other  
13 property to another person and the principal purpose of  
14 such transfer is to secure or increase an adjustment under  
15 subsection (a), the Secretary may disallow part or all of  
16 such adjustment or increase.

17 “(i) SPECIAL RULES.—For purposes of this section—

18 “(1) TREATMENT OF IMPROVEMENTS, ETC.—If  
19 there is an addition to the adjusted basis of any tan-  
20 gible property or of any stock in a corporation dur-  
21 ing the taxable year by reason of an improvement to  
22 such property or a contribution to capital of such  
23 corporation—

24 “(A) such addition shall never be taken  
25 into account under subsection (e)(1)(A) if the

1 aggregate amount thereof during the taxable  
2 year with respect to such property or stock is  
3 less than \$1,000, and

4 “(B) such addition shall be treated as a  
5 separate asset acquired at the close of such tax-  
6 able year if the aggregate amount thereof dur-  
7 ing the taxable year with respect to such prop-  
8 erty or stock is \$1,000 or more.

9 A rule similar to the rule of the preceding sentence  
10 shall apply to any other portion of an asset to the  
11 extent that separate treatment of such portion is ap-  
12 propriate to carry out the purposes of this section.

13 “(2) ASSETS WHICH ARE NOT INDEXED ASSETS  
14 THROUGHOUT HOLDING PERIOD.—The applicable in-  
15 flation adjustment shall be appropriately reduced for  
16 periods during which the asset was not an indexed  
17 asset.

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

22 “(4) ACQUISITION DATE WHERE THERE HAS  
23 BEEN PRIOR APPLICATION OF SUBSECTION (a)(1)  
24 WITH RESPECT TO THE TAXPAYER.—If there has  
25 been a prior application of subsection (a)(1) to an

1 asset while such asset was held by the taxpayer, the  
2 date of acquisition of such asset by the taxpayer  
3 shall be treated as not earlier than the date of the  
4 most recent such prior application.

5 “(5) COLLAPSIBLE CORPORATIONS.—The appli-  
6 cation of section 341(a) (relating to collapsible cor-  
7 porations) shall be determined without regard to this  
8 section.

9 “(j) REGULATIONS.—The Secretary shall prescribe  
10 such regulations as may be necessary or appropriate to  
11 carry out the purposes of this section.”.

12 (b) CLERICAL AMENDMENT.—The table of sections  
13 for part II of subchapter O of chapter 1 of such Code  
14 is amended by inserting after the item relating to section  
15 1022 the following new item:

“Sec. 1023. Indexing of certain assets acquired after December  
31, 2001, for purposes of determining gain.”.

16 (c) 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, 2001.

21 (2) CERTAIN TRANSACTIONS BETWEEN RE-  
22 LATED PERSONS.—The amendments made by this  
23 section shall not apply to the disposition of any  
24 property acquired after December 31, 2001, from a

1 related person (as defined in section 1023(g)(2) of  
2 the Internal Revenue Code of 1986, as added by this  
3 section) if—

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

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

10 (d) ELECTION TO RECOGNIZE GAIN ON ASSETS  
11 HELD ON JANUARY 1, 2002.—For purposes of the Inter-  
12 nal Revenue Code of 1986—

13 (1) IN GENERAL.—A taxpayer other than a cor-  
14 poration may elect to treat—

15 (A) any readily tradable stock (which is an  
16 indexed asset) held by such taxpayer on Janu-  
17 ary 1, 2002, and not sold before the next busi-  
18 ness day after such date, as having been sold  
19 on such next business day for an amount equal  
20 to its closing market price on such next busi-  
21 ness day (and as having been reacquired on  
22 such next business day for an amount equal to  
23 such closing market price), and

24 (B) any other indexed asset held by the  
25 taxpayer on January 1, 2001, as having been

1 sold on such date for an amount equal to its  
2 fair market value on such date (and as having  
3 been reacquired on such date for an amount  
4 equal to such fair market value).

5 (2) TREATMENT OF GAIN OR LOSS.—

6 (A) Any gain resulting from an election  
7 under paragraph (1) shall be treated as received  
8 or accrued on the date the asset is treated as  
9 sold under paragraph (1) and shall be recog-  
10 nized notwithstanding any provision of the In-  
11 ternal Revenue Code of 1986.

12 (B) Any loss resulting from an election  
13 under paragraph (1) shall not be allowed for  
14 any taxable year.

15 (3) ELECTION.—An election under paragraph  
16 (1) shall be made in such manner as the Secretary  
17 of the Treasury or his delegate may prescribe and  
18 shall specify the assets for which such election is  
19 made. Such an election, once made with respect to  
20 any asset, shall be irrevocable.

21 (4) READILY TRADABLE STOCK.—For purposes  
22 of this subsection, the term “readily tradable stock”  
23 means any stock which, as of January 1, 2002, is  
24 readily tradable on an established securities market  
25 or otherwise.

1 **SEC. 3. REPEAL OF SPECIAL RATES OF TAX ON CAPITAL**  
2 **GAIN.**

3 (a) IN GENERAL.—Section 1 of the Internal Revenue  
4 Code of 1986 is amended by striking subsection (h).

5 (b) CONFORMING AMENDMENTS.—

6 (1) Section 641(c)(2)(A) of such Code is  
7 amended by striking “Except as provided in section  
8 1(h), the” and inserting “The”.

9 (2) Paragraph (4) of section 691(c) of such  
10 Code is amended by striking “1(h),”.

11 (3) The second sentence of section  
12 7518(g)(6)(A) of such Code is amended to read as  
13 follows:

14 “In the case of a corporation, with respect to the  
15 portion of any nonqualified withdrawal made out of  
16 the capital gain account during a taxable year to  
17 which section 1201(a) applies, the rate of tax taken  
18 into account under the preceding sentence shall not  
19 exceed 34 percent.”

20 (4) The second sentence of section 607(h)(6)(A)  
21 of the Merchant Marine Act, 1936, is amended to  
22 read as follows:

23 “In the case of a corporation, with respect to the  
24 portion of any nonqualified withdrawal made out of  
25 the capital gain account during a taxable year to  
26 which section 1201(a) of the Internal Revenue Code

1 of 1986 applies, the rate of tax taken into account  
2 under the preceding sentence shall not exceed 34  
3 percent.”

4 (c) EFFECTIVE DATE.—The amendments made by  
5 this section shall apply to any disposition of property to  
6 which the amendments made by section 2 apply.

○