To amend the Internal Revenue Code of 1986 to provide for the indexing of certain assets for purposes of determining gain or loss.

IN THE SENATE OF THE UNITED STATES

Mr. Cruz (for himself and Mr. INHOFE) introduced the following bill; which was read twice and referred to the Committee on ________________

A BILL

To amend the Internal Revenue Code of 1986 to provide for the indexing of certain assets for purposes of determining gain or loss.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Capital Gains Inflation Relief Act of 2018”.

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

(a) In General.—Part II of subchapter O of chapter 1 of the Internal Revenue Code of 1986 (relating to basis rules of general application) is amended by redesign-
nating section 1023 as section 1024 and by inserting after section 1022 the following new section:

“SEC. 1023. INDEXING OF CERTAIN ASSETS FOR PURPOSES OF DETERMINING GAIN OR LOSS.

“(a) General Rule.—

“(1) Indexed basis substituted for adjusted basis.—Solely for purposes of determining gain or loss on the sale or other disposition by a taxpayer (other than a corporation) of an indexed asset which has been held for more than 3 years, the indexed basis of the asset shall be substituted for its adjusted basis.

“(2) Exception for depreciation, etc.—The deductions for depreciation, depletion, and amortization shall be determined without regard to the application of paragraph (1) to the taxpayer or any other person.

“(3) Written documentation requirement.—Paragraph (1) shall apply only with respect to indexed assets for which the taxpayer has written documentation of the original purchase price paid or incurred by the taxpayer to acquire such asset.

“(b) Indexed Asset.—

“(1) In general.—For purposes of this section, the term ‘indexed asset’ means—
“(A) common stock in a C corporation
(other than a foreign corporation), or
“(B) tangible property,
which is a capital asset or property used in the trade
or business (as defined in section 1231(b)).

“(2) Stock in certain foreign corporations included.—For purposes of this section—

“(A) In general.—The term ‘indexed asset’ includes common stock in a foreign cor-
poration which is regularly traded on an estab-
lished securities market.

“(B) Exception.—Subparagraph (A) shall not apply to—

“(i) stock of a foreign investment company,

“(ii) stock in a passive foreign investment company (as defined in section 1296),

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

“(iv) stock in a foreign personal hold-
ing company.
“(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.

“(c) Indexed Basis.—For purposes of this section—

“(1) General Rule.—The indexed basis for any asset is—

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

“(B) the applicable inflation adjustment.

“(2) Applicable Inflation Adjustment.—

The applicable inflation adjustment for any asset is an amount equal to—

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

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

“(i) the gross domestic product deflator for the last calendar quarter ending before the asset is disposed of, exceeds

“(ii) the gross domestic product deflator for the last calendar quarter ending before the asset was acquired by the taxpayer.
The percentage under subparagraph (B) shall be rounded to the nearest \(\frac{1}{10}\) of 1 percentage point.

“(3) Gross Domestic Product Deflator.—

The gross domestic product deflator for any calendar quarter is the implicit price deflator for the gross domestic product for such quarter (as shown in the last revision thereof released by the Secretary of Commerce before the close of the following calendar quarter).

“(d) Suspension of Holding Period Where Diminished Risk of Loss; Treatment of Short Sales.—

“(1) In general.—If the taxpayer (or a related person) enters into any transaction which substantially reduces the risk of loss from holding any asset, such asset shall not be treated as an indexed asset for the period of such reduced risk.

“(2) Short sales.—

“(A) In general.—In the case of a short sale of an indexed asset with a short sale period in excess of 3 years, for purposes of this title, the amount realized shall be an amount equal to the amount realized (determined without regard to this paragraph) increased by the applicable inflation adjustment. In applying sub-
section (c)(2) for purposes of the preceding sentence, the date on which the property is sold short shall be treated as the date of acquisition and the closing date for the sale shall be treated as the date of disposition.

“(B) Short sale period.—For purposes of subparagraph (A), the short sale period begins on the day that the property is sold and ends on the closing date for the sale.

“(e) Treatment of regulated investment companies and real estate investment trusts.—

“(1) Adjustments at entity level.—

“(A) In general.—Except as otherwise provided in this paragraph, the adjustment under subsection (a) shall be allowed to any qualified investment entity (including for purposes of determining the earnings and profits of such entity).

“(B) Exception for corporate shareholders.—Under regulations—

“(i) in the case of a distribution by a qualified investment entity (directly or indirectly) to a corporation—

“(I) the determination of whether such distribution is a dividend shall be
made without regard to this section, and

“(II) the amount treated as gain by reason of the receipt of any capital gain dividend shall be increased by the percentage by which the entity’s net capital gain for the taxable year (determined without regard to this section) exceeds the entity’s net capital gain for such year determined with regard to this section, and

“(ii) there shall be other appropriate adjustments (including deemed distributions) so as to ensure that the benefits of this section are not allowed (directly or indirectly) to corporate shareholders of qualified investment entities.

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

“(C) Exception for Qualification Purposes.—This section shall not apply for purposes of sections 851(b) and 856(c).
“(D) Exception for certain taxes imposed at entity level.—

“(i) Tax on failure to distribute entire gain.—If any amount is subject to tax under section 852(b)(3)(A) for any taxable year, the amount on which tax is imposed under such section shall be increased by the percentage determined under subparagraph (B)(i)(II). A similar rule shall apply in the case of any amount subject to tax under paragraph (2) or (3) of section 857(b) to the extent attributable to the excess of the net capital gain over the deduction for dividends paid determined with reference to capital gain dividends only. The first sentence of this clause shall not apply to so much of the amount subject to tax under section 852(b)(3)(A) as is designated by the company under section 852(b)(3)(D).

“(ii) Other taxes.—This section shall not apply for purposes of determining the amount of any tax imposed by paragraph (4), (5), or (6) of section 857(b).
“(2) Adjustments to interests held in

   entity.—

   “(A) Regulated investment companies.—Stock in a regulated investment com-

   pany (within the meaning of section 851) shall be an indexed asset for any calendar quarter in

   the same ratio as—

   “(i) the average of the fair market

   values of the indexed assets held by such

   company at the close of each month during

   such quarter, bears to

   “(ii) the average of the fair market

   values of all assets held by such company

   at the close of each such month.

   “(B) Real estate investment

   trusts.—Stock in a real estate investment

   trust (within the meaning of section 856) shall be an indexed asset for any calendar quarter in

   the same ratio as—

   “(i) the fair market value of the in-

   dexed assets held by such trust at the close

   of such quarter, bears to

   “(ii) the fair market value of all as-

   sets held by such trust at the close of such

   quarter.
“(C) Ratio of 80 percent or more.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 80 percent or more, such ratio for such quarter shall be 100 percent.

“(D) Ratio of 20 percent or less.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 20 percent or less, such ratio for such quarter shall be zero.

“(E) Look-thru of partnerships.—For purposes of this paragraph, a qualified investment entity which holds a partnership interest shall be treated (in lieu of holding a partnership interest) as holding its proportionate share of the assets held by the partnership.

“(3) Treatment of return of capital distributions.—Except as otherwise provided by the Secretary, a distribution with respect to stock in a qualified investment entity which is not a dividend and which results in a reduction in the adjusted basis of such stock shall be treated as allocable to stock acquired by the taxpayer in the order in which such stock was acquired.
“(4) QUALIFIED INVESTMENT ENTITY.—For purposes of this subsection, the term ‘qualified investment entity’ means—

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

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

“(f) OTHER PASS-THRU ENTITIES.—

“(1) PARTNERSHIPS.—

“(A) IN GENERAL.—In the case of a partnership, the adjustment made under subsection (a) at the partnership level shall be passed through to the partners.

“(B) SPECIAL RULE IN THE CASE OF SECTION 754 ELECTIONS.—In the case of a transfer of an interest in a partnership with respect to which the election provided in section 754 is in effect—

“(i) the adjustment under section 743(b)(1) shall, with respect to the transferor partner, be treated as a sale of the partnership assets for purposes of applying this section, and

“(ii) with respect to the transferee partner, the partnership’s holding period
for purposes of this section in such assets shall be treated as beginning on the date of such adjustment.

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

“(3) COMMON TRUST FUNDS.—In the case of a common trust fund, the adjustment made under subsection (a) at the trust level shall be passed through to the participants.

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

“(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

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

“(2) RELATED PERSONS DEFINED.—For purposes of this section, the term ‘related persons’ means—

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

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

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

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

“(1) TREATMENT OF IMPROVEMENTS, ETC.—If there is an addition to the adjusted basis of any tangible property or of any stock in a corporation during the taxable year by reason of an improvement to such property or a contribution to capital of such corporation—

“(A) such addition shall never be taken into account under subsection (c)(1)(A) if the
aggregate amount thereof during the taxable year with respect to such property or stock is less than $1,000, and

“(B) such addition shall be treated as a separate asset acquired at the close of such taxable year if the aggregate amount thereof during the taxable year with respect to such property or stock is $1,000 or more.

A rule similar to the rule of the preceding sentence shall apply to any other portion of an asset to the extent that separate treatment of such portion is appropriate to carry out the purposes of this section.

“(2) Assets which are not indexed assets throughout holding period.—The applicable inflation adjustment shall be appropriately reduced for periods during which the asset was not an indexed asset.

“(3) Treatment of certain distributions.—A distribution with respect to stock in a corporation which is not a dividend shall be treated as a disposition.

“(4) Section cannot increase ordinary loss.—To the extent that (but for this paragraph) this section would create or increase a net ordinary loss to which section 1231(a)(2) applies or an ordi-
nary loss to which any other provision of this title applies, such provision shall not apply. The taxpayer shall be treated as having a long-term capital loss in an amount equal to the amount of the ordinary loss to which the preceding sentence applies.

“(5) Acquisition date where there has been prior application of subsection (a)(1) with respect to the taxpayer.—If there has been a prior application of subsection (a)(1) to an asset while such asset was held by the taxpayer, the date of acquisition of such asset by the taxpayer shall be treated as not earlier than the date of the most recent such prior application.

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

(b) Clerical Amendment.—The table of sections for part II of subchapter O of chapter 1 of the Internal Revenue Code of 1986 is amended by striking the item relating to section 1023 and by inserting after the item relating to section 1022 the following new item:

“Sec. 1022. Indexing of certain assets for purposes of determining gain or loss.
“Sec. 1023. Cross references.”.

(e) Effective Date.—The amendments made by this section shall apply to indexed assets acquired by the
taxpayer after December 31, 2018, in taxable years ending after such date.