

MEMO# 9324

October 10, 1997

TECHNICAL CORRECTIONS TO CAPITAL GAINS RULES

1 The attachment also contains a description of the proposed changes that was prepared by the Joint Committee on Taxation. 2 See Institute Memorandum to Tax Members No. 27-97, Accounting/Treasurers Members No. 31-97, Operations Members No. 13-97, International Members No. 12-97, Closed-End Investment Company Members No. 23-97, Unit Investment Trust Members No. 28-97 and Transfer Agent Advisory Committee No. 36-97, dated August 1, 1997. 3 See Institute Memorandum to Tax Committee No. 35-97, Accounting/Treasurers Committee No. 39-97, Operations Committee No. 35-97, Transfer Agent Advisory Committee No. 54-97 and Broker/Dealer Advisory Committee No. 15-97, dated October 8, 1997. [9324] October 10, 1997 TO: TAX MEMBERS No. 37-97 ACCOUNTING/TREASURERS MEMBERS No. 40-97 OPERATIONS MEMBERS No. 22-97 CLOSED-END INVESTMENT COMPANY MEMBERS No. 29-97 UNIT INVESTMENT TRUST MEMBERS No. 40-97 TRANSFER AGENT ADVISORY COMMITTEE No. 56-97 RE: TECHNICAL CORRECTIONS TO CAPITAL GAINS RULES

The House Ways and Means Committee has approved for consideration by the House of Representatives the "Tax Technical Corrections Act of 1997," which is cosponsored by the Committee's senior Republican and Democrat (Chairman Archer and Representative Rangel) and supported by the Treasury Department. Among other things, the technical corrections bill would substitute the attached revised version of Internal Revenue Code section 1(h)¹ for the version originally included in the Taxpayer Relief Act of 1997,² thereby modifying the capital gains rules in several ways. While there can be no assurances that this bill will be enacted during 1997, the strong bipartisan support that it has received and the retroactive impact it would have on the law may lead the Internal Revenue Service ("IRS") to administer the tax laws for 1997 as if this technical corrections legislation applies. For example, the draft version of the Schedule D (used by individuals to report capital gains and losses) that IRS has submitted for approval by the Office of Management and Budget ("OMB") reflects the proposed changes.³ Under the technical corrections bill, all gains and losses on assets taxed at a maximum tax rate of 28 percent would be combined into a new category of gain called "28 percent rate gain," which would be defined in revised section 1(h)(5). The present-law definitions of "mid-term gain and loss" and "pre-effective date gain and loss" would be eliminated. Another effect of this new 28 percent rate gain category would be to net all gains and losses on assets taxed at a 28 percent rate first; under the original Act, a net mid-term loss offsets gain taxed at a 20 percent maximum rate before it offsets collectibles gain taxed at a 28 percent maximum rate. Under an additional modification made by technical corrections, all losses on collectibles held for more than one year would be treated as "collectibles losses" and netted against collectibles gain; under the original Act, which contains no special rules for collectibles losses, any loss on a

collectible held for more than 18 months is treated as a more-than-18- month loss that offsets gain on non-collectibles held for more than 18 months before it offsets gain on other collectibles. The rules for netting gains and losses also would be modified in other ways. First, any net short-term loss for a taxable year would offset 28 percent rate gain first; under the original Act, net short-term loss first offsets gain taxed at a 20 percent maximum rate. Second, any long- term capital loss carryover would be treated as 28 percent rate loss that first offsets any 28 percent rate gain. Third, any net loss in the 28 percent rate gain basket would offset gain taxed at the 25 percent maximum rate (called "unrecaptured section 1250 gain") before offsetting gain taxed at the 20 percent maximum rate; under the original Act, 28 percent rate losses offset gains taxed at a maximum rate of 28 percent before they offset gains taxed at a maximum rate of 25 percent. Technical corrections also would make other changes. First, the bill would clarify that any gain or loss on a section 1256 contract would be treated as gain or loss from property held for more than 18 months. Inherited property would be deemed under the bill to have a holding period of more than 18 months. Finally, conforming changes to the holding period rules of section 1233 (relating to short sales) and section 1092(f) (relating to qualified covered calls) would be made to cover situations in which assets were held for more than a year but not more than 18 months. Keith D. Lawson Associate Counsel - Tax Attachment (in .pdf format) Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Library Services Division at (202)326-8304, and ask for this memo's attachment number: 9324.

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