Capital Gains Inflation Relief Act

SHORT SUMMARY

CURRENT LAW:

After the sale of a capital asset, taxpayers generally owe capital gains tax on the difference between the amount of cash received and the asset's adjusted base, subject to certain considerations. Assets are not indexed for inflation, meaning that taxpayers often owe a much higher effective rate than the statutory capital gains rate.

WHAT THE BILL DOES:

The Capital Gains Inflation Relief Act would stop Americans from paying capital gains taxes on inflation. The measure will benefit nearly all types of investors and all sizes of business, creating incentives for both individual and business investment that would expand the economy and create jobs.

This bill would allow taxpayers to use the indexed basis instead of the property's adjusted basis for determining the gain or loss of an indexed asset that has been held for more than three years.

A taxpayer's indexed basis is determined by increasing the asset's adjusted basis by a percentage determined by comparing the gross domestic product deflator (GDPD) for the quarter ending before the sale date against the GDPD for the quarter ending before the acquisition date. The GDPD is published by the Department of Commerce.

Assets eligible to be indexed include:

1. Stock of a domestic C corporation.
2. Stock of a foreign C corporation that is regularly traded on an established securities market, unless such stock is:
    a. stock in a passive foreign investment company (a PFIC);
    b. stock in a foreign corporation held by a U.S. person who meets the requirements of section 1248(a)(2).
3. Tangible property which is a capital asset or property used in a trade or business (*e.g.*, real property and machinery).

SPECIAL RULES:

Special rules would apply (i) to suspend a taxpayer's holding period where a taxpayer enters into a transaction in which his risk of loss is diminished and (ii) if a taxpayer enters into a short sale of an indexed asset.

Special rules would generally apply that allow Regulated Investment Companies (RICs or Mutual Funds) and Real Estate Investment Trusts (REITs) to apply these indexing rules to their investments to the extent of their non-C corporation shareholder ownership. Additionally, stock in RICs and REITs shall be indexed assets by calculating the ratio of indexed assets over total assets.

Special rules would generally apply these indexing rules at the partnership and S corporation level and any such adjustment to the basis shall be passed through to the partners and shareholders.

EXAMPLE:

A taxpayer purchases 100 shares of XYZ, Inc. on January 1, 2019 for $100. The taxpayer sells the shares 5 years later on January 1, 2024 for $200. Assume that, when comparing the GDPD for the relevant quarters, the GDPD increased by 15%. Thus, the taxpayer's indexed basis is determined by increasing his adjusted basis by 15%, or $15 (which is $100 multiplied by 15%). As a result, the taxpayer recognizes $85 (which is $200 minus $115) of capital gain on the sale of his XYZ, Inc. stock.