MEMO# 7359

October 20, 1995

FINANCE COMMITTEE APPROVES TAX PROVISIONS

October 20, 1995 TO: BOARD OF GOVERNORS No. 71-95 FEDERAL LEGISLATION MEMBERS No. 22-95 30% REPEAL WORKING GROUP RE: FINANCE COMMITTEE APPROVES TAX PROVISIONS ____ The Senate Finance Committee on October 19, 1995 approved tax provisions to be part of the budget reconciliation bill designed to meet the Congress's deficit reduction and tax cut goals. We are pleased to report that the tax provisions include several items on the Institute's legislative agenda: IRA expansion; small employer pension expansion; and bank common trust fund conversions. IRA EXPANSION IRA Eligibility Increase by $5,000 a year for 12 years the income limits on eligibility for full deductibility of IRA contributions, from the present $40,000 for couples and $25,000 for individuals ultimately to $100,000 for couples and $85,000 for individuals. (These limits would be subsequently indexed for inflation in $5,000 increments.) Penalty-Free Withdrawals Provide penalty-free withdrawals for first-home purchases, higher education expenses, financially devastating medical expenses, and during periods of unemployment. New "IRA-Plus" Account Present-law nondeductible IRAs would be replaced with new "IRA-plus" accounts which would not have an income limit on eligibility. Contributions to an IRA-plus account would not be tax-deductible. Withdrawals from an IRA-plus account would not be includible in income or subject to a 10 percent early withdrawal tax if attributable to contributions that had been held in the IRA-plus account for at least five years and were either (1) made after the individual attained age 59½ or (2) made for one of the special early withdrawal purposes, or on account of death or disability, or in the form of an annuity. Other withdrawals would be taxable to the extent of earnings on contributions. Spousal IRA Permit each spouse in a married couple a $2,000 annual IRA contribution. -2- Limit on Contributions The total annual contribution by an individual to both an IRA and an IRA-plus account could not exceed $2,000. The $2,000 limit would be indexed for inflation in $500 increments. SMALL EMPLOYER PENSION EXPANSION A new simplified retirement plan would be created for small businesses with 100 or fewer employees, called the SIMPLE retirement plan. A SIMPLE plan could be either an IRA for each employee or part of a 401(k) plan. Employees could contribute up to $6,000 of their wages; employers would generally have to match employee contributions up to 3% of the employee's pay. SIMPLE plans would not be subject to nondiscrimination or top-heavy rules. All contributions to an employee's account would be fully vested. In addition, the bill includes miscellaneous pension simplification provisions. BANK COMMON TRUST FUND CONVERSION Allow a bank common trust fund to transfer its assets to one or more mutual funds without being subject to taxation. SHAREHOLDER BASIS REPORTING The Committee bill does not include a provision requiring mutual funds to report the basis of shares redeemed by shareholders (though such a provision has been included in tax simplification legislation in the past). The Institute has advocated enacting the first three of these items and dropping mandated shareholder basis reporting. In earlier action, the House Ways and Means Committee tax bill approved last month includes the American Dream Savings Account (similar to the IRA-plus account in the Finance Committee bill). The House bill also includes pension simplification provisions for small employer plans similar to the provisions incorporated in the Finance Committee bill. Neither the House nor Senate bill would require shareholder basis reporting. Unlike the House bill, the Finance Committee bill does not include tax simplification provisions, including a provision to repeal the 30% limitation (the "short-short" rule). The Institute will work through Conference to include this provision in the final version of the bill. We will keep you informed as this matter develops. For additional information, please contact the Legislative Affairs Department at (202) 326-5890. This memo can be found on FUNDs, the Institute's Fund User Network and Delivery System, under "Legislative Affairs; Washington Update." Julie Domenick Senior Vice President Legislative Affairs

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