MEMO# 9655

February 9, 1998

PRESIDENT SUBMITS FISCAL-YEAR 1999 BUDGET

[9655] February 9, 1998 TO: BOARD OF GOVERNORS No. 5-98 FEDERAL LEGISLATION MEMBERS No. 2-98 PRIMARY CONTACTS - MEMBER COMPLEX No. 4-98 PUBLIC INFORMATION COMMITTEE No. 2-98 RE: PRESIDENT SUBMITS FISCAL-YEAR 1999 BUDGET ____ On February 2, President Clinton released his fiscal-year 1999 Budget proposal. It includes a series of provisions relating to retirement security, private pension plan coverage and the tax treatment of foreign investors in U.S. mutual funds. It also calls for the repeal of the ERISA limited scope audit provision. Retirement and Pension Issues The budget includes the following provisions related to retirement and pension security: IRA payroll deductions. When employees contribute to IRAs through employer payroll deduction programs, the contributions would be excluded from taxable income (rather than being deducted from income on the individual's tax return). Employer tax credit. Small businesses establishing pension programs would be eligible for a tax credit of 50 percent of administrative and retirement education expenses associated with the pension plan, up to $1,000 in the first year and $500 in the second and third year. SMART plan. Small businesses with 100 or fewer employees would be able to offer another kind of pension plan, the Secure Money Annuity or Retirement Trust (SMART) plan. Plan participants would be guaranteed a minimum annual benefit upon retirement, but could receive a larger benefit if the return on plan investments exceeds a five percent rate of return. Faster 401(k) vesting. All employees participating in a 401(k) plan would be fully vested in the employer's matching contributions after three years of service (rather than five years as under present law), or over six years (rather than seven) if vesting is incremental. Pension plan information. 1) Spouses would be provided a description of the methods (e.g., annual payment, lump sum) by which pension benefits can be distributed to help them participate in the decisionmaking process; 2) every three years participants in defined- benefit plans would automatically be provided with a statement disclosing the benefit payable at retirement if they left their employer as of the date of the statement; and 3) participants in defined-contribution plans would be provided such a statement at least annually. Limited scope audit repeal. The ERISA limited scope audit provision would be repealed. Budget surplus held pending Social Security reform. The President's budget also recommends that "Congress should not spend a budget surplus for any reason until we have a solution to the long-term financing challenge facing Social Security." President Clinton also made this recommendation in his January 27 State of the Union address. Tax Issues There are two tax issues of interest to the investment company industry: Flow-through of interest income. Under present law, interest income and short-term capital gains received by a U.S. mutual fund are recharacterized as dividend income, which is subject to U.S. withholding tax when distributed to foreign investors. No U.S. withholding tax is imposed, however, on interest income and short-term capital gains received by foreign investors from either direct investments or investments through foreign mutual funds. Under a proposal in the President's FY99 Budget, no U.S. withholding tax would be imposed on distributions from U.S. bond funds. No average cost basis requirement. Unlike the President's budgets submitted in the past two years, the fiscal-year 1999 proposal does not include a provision to require taxpayers to use the average cost basis method in determining capital gains. The Institute had opposed such a provision. SEC Receives Increased Funding The President's budget proposes $341 million for the Securities and Exchange Commission, eight percent above the current fiscal year, in large part for increased staffing. Under the National Securities Markets Improvement Act of 1996, on October 1, 1998 the SEC registration fee rates for fiscal-year 1999 will drop to .000278 (approximately 1/36 of one percent) from the current level of .000295. We will keep you informed of further developments. Matthew P. Fink President

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