MEMO# 9000

June 20, 1997

# SENATE FINANCE COMMITTEE APPROVES REPEAL OF 30% LIMITATION, AND APPROVES OTHER TAX PROVISIONS

1 See Memorandum to Board of Governors No. 37-97, Federal Legislation Members No. 8-97, Primary Contacts - Member Complex, and Public Information Committee No. 19-97, dated June 13, 1997. June 20, 1997 TO: BOARD OF GOVERNORS No. 38-97 FEDERAL LEGISLATION MEMBERS No. 9-97 PRIMARY CONTACTS - MEMBER COMPLEX No. 40-97 PUBLIC INFORMATION COMMITTEE No. 20-97 RE: SENATE FINANCE COMMITTEE APPROVES REPEAL OF 30% LIMITATION, AND APPROVES OTHER TAX PROVISIONS ____________________________________________________________________________ Following last weeks action by the House Ways and Means Committee,1 the Senate Finance Committee on June 19 approved tax legislation that includes a number of items of interest to the investment company industry: 30% limitation ("short-short" rule) The 30% limitation on the sale or disposition of securities held for less than three months by regulated investment companies would be repealed (a similar repeal provision was approved by the Ways and Means Committee). IRA expansion: nondeductible accounts Present-law nondeductible IRAs would be replaced with new "IRA Plus Accounts," which would not have an income eligibility limit. Contributions to an IRA Plus account would not be tax-deductible. However, withdrawals from the account would not be included as income or subject to a 10-percent early withdrawal tax if the individual has established an account that is at least five years old and the withdrawals were either: 1) made after the individual attained 59½; or 2) were made for a first-time home purchase, higher education expenses, 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 and also subject to a 10-percent early withdrawal tax. (The Ways and Means bill would establish similar "American Dream IRA Accounts.") Education IRAs An Education IRA could be established for a child under age 18, with annual nondeductible contributions limited to $2,000 per child (or $2,500 if the child is also eligible for the $500 child care tax credit provided elsewhere in the Finance Committee bill). The $500 child care tax credit for children age 13 to 16 would only be allowed if the credit were deposited into an Education IRA or into a qualified tuition program. (The Ways and Means bill would establish somewhat different "education investment accounts.") -2- Spousal IRA An individuals eligibility to contribute to a deductible IRA would no longer be affected by the spouses coverage under an employer pension plan. (The Ways and Means bill does not include such a provision.) Other IRA provisions 1) Current income limits for completely deductible IRA eligibility ($25,000 for individuals, $40,000 for couples) would be increased over time until doubled (to $50,000 for individuals, $80,000 for couples) by 2004. 2) Penalty-free IRA withdrawals would be provided for first-time home purchases, higher education expenses, and long- term unemployment. 3) IRAs would to be permitted to be

invested in bullion. (The Ways and Means bill would allow penalty-free IRA withdrawals for higher education expenses.) Capital gains The maximum capital gain tax rate for individuals would be reduced from 28 percent to 20 percent (or to 10 percent for lower-income persons taxed at a 15 percent rate), effective May 7, 1997. (Unlike the Ways and Means bill, there would be no provision for indexing assets for capital gains purposes.) Pension simplification The Finance Committee bill contains a number of pension simplification items, including: 1) the 15 percent excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs (currently suspended until 2000), as well as the 15 percent estate tax on excess retirement accumulations, would be repealed; 2) matching contributions for partners in 401(k) plans would be treated the same as matching contributions for employeesthat is, they would not be subject to the $9,500 elective contribution limit; 3) employers could unilaterally cash out pension benefits of terminating employees where the benefits have present value of less than $5,000 (rather than $3,500, as under present law); and 4) employers without qualified retirement plans and who establish payroll deduction plans for employee IRAs would not be subject to ERISA. (Item 3 is also in the Ways and Means bill; the other provisions are not.) Spousal consent for 401(k) withdrawals Spousal consent would be required for 401(k) plan withdrawals; without such consent, distributions would have to be made in the form of periodic payments. (There is no comparable provision in the Ways and Means bill.) Simplified foreign tax credit Mutual fund shareholders generally would no longer be required to fill out a special form to accompany their tax returns in order to take the foreign tax credit. (There is a similar provision in the Ways and Means bill.) Passive Foreign Investment Companies (PFICs) PFIC shareholders (including mutual funds) would generally be able to elect to realize their gains annually for tax purposes, and thus avoid the anti-deferral penalties under present law. (There is a similar provision in the Ways and Means bill.) We will keep you informed as these issues develop. Matthew P. Fink President

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