

MEMO# 3994

September 30, 1992

SENATE APPROVES REVENUE ACT OF 1992

September 30, 1992 TO: BOARD OF GOVERNORS NO. 72-92 RE: SENATE APPROVES REVENUE ACT OF 1992 _____

The Senate late yesterday approved tax legislation containing several provisions relevant to the investment company industry. Many of the provisions contained in this bill are substantially identical to provisions contained in the bill passed by the House of Representatives in July (see Institute Memorandum to Board of Governors No. 43-92, dated July 2, 1992) and in the earlier legislation vetoed by the President in March. (See Institute Memorandum to Board of Governors No. 19-92, dated March 23, 1992.)

I. Mutual Fund Tax Simplification The Senate bill would permit the tax-free conversion of (a) bank common trust funds into regulated investment companies ("RICs") and (b) RICs into bank common trust funds. Neither of the other two mutual fund tax simplification provisions contained in the House bill (repeal of the 30 percent test and shareholder basis reporting) is included in the Senate bill. However, either or both of these provisions could be included in any legislation resulting from a joint House-Senate conference.

II. Individual Retirement Arrangements (IRAs) The Senate bill would expand eligibility for deductible IRA contributions. Under the bill, taxpayers covered by retirement plans could fully deduct IRA contributions if their adjusted gross incomes were under \$80,000 for individuals, or \$120,000 for joint filers, effective after December 31, 1993. The IRA deduction would be subject to a last-dollar offset to the limit on elective deferrals to section 401(k) and similar plans. One spouse's coverage under a retirement plan would not affect the other spouse's eligibility for the deduction, and the income limitations and the maximum deductible amount would be indexed for inflation. The bill would also permit the establishment of special IRAs, the contributions to which would not be deductible, but withdrawals from which would be tax free if attributable to - 1 - contributions held for more than five years. Contributions to special IRAs would also be subject to the income limitations and the last-dollar offset to the 401(k) plan limit. Penalty-free transfers from deductible IRAs to special IRAs would be permitted after December 31, 1992, subject to the income limitations, and would qualify for favorable tax treatment if accomplished before January 1, 1994. Penalty-free withdrawals from IRAs, section 401(k) plans and section 403(b) arrangements would be permitted for purchases of new American made automobiles during 1992 and 1993, and for first-time home purchases, educational expenses, and medical expenses, and from IRAs for the long-term unemployed, effective after December 31, 1992.

III. International Competitiveness Provisions The Senate bill would generally permit U.S. source interest income and short-term capital gains received by a fund to flow through to foreign shareholders free from U.S. withholding tax. Similar flow-through provisions were contained in S. 1748, the Investment Competitiveness Act of 1991, which was introduced last fall by Senator Baucus. (See Institute Memorandum to Board of Governors No. 77-91, dated September 27, 1991.)

IV. Foreign Investment Provisions The

Senate bill would generally allow fund shareholders with no more than \$200 of creditable foreign taxes to elect a simplified method for claiming the foreign tax credit. In addition, the Senate bill would require that shares of passive foreign corporations ("PFCs") held by RICs be marked to market each year at October 31, for excise tax purposes, and at the RIC's fiscal year-end, for income tax purposes.

V. Amortization of Intangibles The Senate bill would require that the purchase price of certain acquired intangible assets, including investment advisory contracts, be amortized over a uniform 16-year period. Taxpayers could elect to apply the provision to all property acquired after July 25, 1991. In addition, taxpayers could elect to retroactively apply the provision to 75 percent of the adjusted basis of the asset for any "open" tax year, with no amortization allowed for the remaining 25 percent.

VI. Education Savings Bond Provisions The Senate bill would expand eligibility for the benefits of Code section 135, which provides that interest income earned on certain qualified U.S. Series EE savings bonds is excludable from gross income if the proceeds of the bond upon redemption do not exceed the qualified higher education expenses paid by the - 2 - taxpayer during the taxable year. Under the bill, qualified - 3 - higher education expenses would include certain amounts paid by the taxpayer to an "eligible educational institution", such as a college, for the tuition and fees of any individual and not simply dependents. The bill would also repeal the present law provision which phases out the section 135 exclusion for married taxpayers filing joint returns with adjusted gross income between \$60,000 and \$90,000 and for single taxpayers with adjusted gross income between \$40,000 and \$55,000.

VII. Backup Withholding The Senate bill would increase the Code section 3406 backup withholding rate from 20 percent to 31 percent. This new rate would apply to amounts paid after December 31, 1992. * * * Copies of relevant Senate Committee Report and statutory bill language may be obtained by calling Kathy Ireland at (202) 955-3516 (pension matters) or Keith Lawson at (202) 955-3585 (tax matters). We will keep you informed of developments regarding this legislation. Kathy D. Ireland Associate Counsel - Pension Keith D. Lawson Associate Counsel - Tax