MEMO# 10048

June 24, 1998

EDUCATION IRA BILL SENT TO PRESIDENT, VETO EXPECTED

[10048] June 24, 1998 TO: PENSION COMMITTEE No. 38-98 RE: EDUCATION IRA BILL SENT TO PRESIDENT, VETO EXPECTED

____ Congress recently passed H.R. 2646, the "Education Savings and School Excellence Act of 1998," which now will be sent to the President. A veto is expected. The bill contains a provision that would raise the annual contribution limit to Education IRAs to $2,000 from $500. It also would permit tax-free withdrawals from Education IRAs to pay for elementary and secondary school education expenses. The Clinton Administration has opposed legislation that would permit such withdrawals from Education IRAs. With respect to the Education IRA, the bill specifically includes the following provisions: 1. The term "qualified education expenses" would be expanded to permit withdrawals from Education IRAs to be used for elementary and secondary school expenses and homeschooling expenses. The bill, however, would permit such use of Education IRA assets only for contributions (and earnings thereon) made during calendar years 1999 to 2002. Such contributions and earnings would be tracked separately by the Education IRA trustee. 2. The contribution limit to Education IRAs would increase from $500 to $2,000 for calendar years 1999 to 2002. 3. The current age limitation on contributions (age 18) to Education IRAs would be waived for designated beneficiaries with special needs. Additionally, there would be no required deemed distribution of any balance in an Education IRA of a special needs beneficiary when the beneficiary reaches age 30. 4. Corporations would be permitted to contribute to Education IRAs (and would not be subject to any type of income limitation on eligibility to make contributions). 5. In the event of death of a designated beneficiary, the balance remaining in the Education IRA would be distributable to a spouse or other contingent beneficiary, and where such beneficiary is a "family member," the beneficiary would become the "designated beneficiary" of the account, which would continue to be treated as an Education IRA; 1 See Institute Memorandum to Pension Committee No. 28-98 and Pension Operations Advisory Committee No. 17-98, dated May 11, 1998. - 2 - 6. The bill makes the following "technical corrections": a. Any balance remaining in an Education IRA would be deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30; b. It would be clarified that distributions from Education IRAs are treated as representing a pro-rata share of the principal and accumulated earnings in the account; c. The 10-percent tax on non-qualified distributions would not be imposed where the distribution is used to pay for qualified education expenses and is includable income solely because the taxpayer also had elected either the HOPE or Lifetime Learning tax credit in that same year; d. The 10-percent tax would not apply to the distribution of any contribution to an Education IRA made during a taxable year if the distribution is made on or before the due date (including extensions) by which the beneficiary is required to file a tax return; e. It would be clarified that tax-free rollovers and account redesignation may be made to a new beneficiary as long as the new beneficiary is under age 30 (rather than under age 18); f. Qualified higher education expenses taken into account when determining the exclusion from taxation under section 530 would not be permitted to be taken into account for a section 162 deduction or section 135 exclusion. The conference report, which includes bill language and the accompanying explanatory statement, is attached. Please note that many of the “technical correction” measures noted in item 6, above, also are included in a different technical corrections bill, which is part of the IRS restructuring package, also being considered by Congress.1 That bill has a greater likelihood of being signed into law this year. Russell G. Galer Senior Counsel Attachment

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