INVESTMENT COMPANY INSTITUTE

MEMO# 1706

February 7, 1990

ADMINISTRATION'S PROPOSED SAVINGS AND ECONOMIC GROWTH ACT

- 1 - February 7, 1990 TO: BOARD OF GOVERNORS NO. 10-90 ACCOUNTING/TREASURERS COMMITTEE NO. 3-90 CLOSED-END FUND COMMITTEE NO. 6-90 OPERATIONS COMMITTEE NO. 2-90 PENSION COMMITTEE NO. 3-90 SEC RULES COMMITTEE NO. 10-90 TAX COMMITTEE NO. 3-90 UNIT INVESTMENT TRUST COMMITTEE NO. 6-90 RE: ADMINISTRATION'S PROPOSED SAVINGS AND ECONOMIC GROWTH ACT ____ Attached is a copy of the Administration's proposed Savings and Economic Growth Act, which was transmitted to Congress on February 1. The following memorandum describes the three components of this proposal. Family Savings Accounts The Administration's proposal would add to the Internal Revenue Code a new provision for the establishment of family savings accounts (FSAs). Married couples with adjusted gross income of $120,000 or less could contribute up to $5,000 to an FSA each year. Single taxpayers with adjusted gross income of $60,000 or less could contribute up to $2,500. FSAs could be invested in any investment except insurance contracts or collectibles. Contributions would not be deductible, but both the contributions and earnings thereon could be withdrawn tax-free if the contribution remained in the FSA for at least seven years. If amounts were withdrawn prior to the expiration of seven years from the date of the contribution to which they were applicable, the earnings would be taxable as ordinary income in the year of the withdrawal. Furthermore, if the amounts were attributable to contributions held less than three years, the earnings would be subject to an additional ten percent tax. The source of a distribution from an FSA would be determined under a first-in, first-out ordering rule. In the case of an FSA originally established with one trustee and - 2 - subsequently transferred to a second trustee, the holding periods under both would be aggregated for purposes of the seven-year rule. The first trustee would be required to provide to the second trustee and to the individual information concerning the "age" of the contributions in the account. Capital Gains Tax Rate Reduction The Administration's capital gains tax proposal would permit individuals (but not corporations) to claim a deduction for a percentage of capital gain realized upon the disposition of certain assets based upon the length of time the assets were held. Shareholders in regulated investment companies (RICs) would be permitted to deduct a percentage of the gains realized both at the fund level, when distributed to shareholders, and at the shareholder level, upon redemption or sale of the RIC shares. The proposal includes a "sliding-scale" capital gains deduction feature whereby the amount of the deduction increases with the length of time the asset is held. For assets held at least 3 years, the deduction would be 30 percent of the realized gain. The deduction would decrease to 20 percent for assets held at least two but less than three years, and to 10 percent for assets held at least one but less than two years. Special transition rules would phase in these new holding period requirements during 1990 and 1991. For example, in

1990 the 30 percent deduction would apply to all assets sold after the proposal's effective date that were held at least one year prior to sale. Withdrawals from IRAs for First-Time Home Purchases The Administration proposal also would permit IRA owners to withdraw up to $10,000 from an IRA for a first-time home purchase on a penalty-free basis. In order to qualify, the cost of the home could not exceed 110 percent of the median home price in the geographic area. We will keep you informed of developments. Kathy D. Ireland Associate General Counsel Keith D. Lawson Assistant General Counsel Attachments

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