

MEMO# 9027

July 1, 1997

TAX BILLS APPROVED IN HOUSE AND SENATE INCLUDE 30 PERCENT LIMITATION REPEAL, IRA EXPANSION

1 See Memoranda to Board of Governors No. 37-97 and 38-97, Federal Legislation Members No. 8-97 and 9-97, Primary Contacts-Member Complex No. 38-97 and 40-97, and Public Information Committee No. 19-97 and 20-97, dated June 13, 1997, and June 20, 1997. July 1, 1997 TO: BOARD OF GOVERNORS No. 42-97 FEDERAL LEGISLATION MEMBERS No. 11-97 PRIMARY CONTACTS - MEMBER COMPLEX No. 44-97 PUBLIC INFORMATION COMMITTEE No. 22-97 RE: TAX BILLS APPROVED IN HOUSE AND SENATE INCLUDE 30 PERCENT LIMITATION REPEAL, IRA EXPANSION

The House and Senate have approved tax legislation pursuant to the budget agreement reached earlier this year between Congress and President Clinton.¹ On June 26, the House approved its version of the tax reduction bill by a vote of 253 to 179. The Senate approved its version of the bill on June 27, by a vote of 80 to 18. The House and Senate are expected to go to conference on the tax bills following the Independence Day congressional recess; a vote on a final measure could take place before the August recess. Both bills contain provisions that would repeal the 30 percent test and expand IRAs. The table below provides a comparison of the provisions in the House and Senate bills that are of greatest interest to mutual fund shareholders and the investment company industry. Subject House Bill Senate Bill 30% limitation ("short-short" rule) Repealed. Repealed. Capital gains Maximum rate for individuals reduced from 28% to 20% (or to 10% for lower-income persons taxed at a 15% rate); assets held at least 3 years after January 1, 2001 could be indexed in determining capital gains. Maximum rates as in House bill; no provision for indexing. IRA expansion, education accounts (1) New nondeductible IRA established; (2) penalty-free IRA withdrawals for higher education expenses; (3) education investment accounts for children under 18 (nondeductible annual contributions of up to \$5,000 per year per child, aggregating to a maximum of \$50,000). (1) New nondeductible IRA established; (2) individual's eligibility to contribute to a deductible IRA no longer affected by a spouse's employer plan coverage; (3) income limits for fully deductible IRA eligibility doubled by 2004; (4) penalty-free withdrawals for first home purchases, higher education expenses, long-term unemployment, property repair following a natural disaster, and adoption expenses; (5) new education IRAs for children under 18 established (nondeductible annual contributions of \$2,000 per child, or \$2,500 if the child is eligible for a \$500 child care tax credit provided elsewhere in the bill). Pension simplification Employers could cash out pension benefits of terminating employees where present value of benefits is less than \$5,000 (compared to \$3,500 under present law); the \$5,000 limit would be indexed. Includes House provision, as well as: (1) matching contributions for partners in 401(k) plans and SIMPLE plans would not

be subject to the \$9,500 limit; and (2) employers without qualified retirement plans and who establish IRA payroll deduction plans would not be subject to ERISA. Spousal consent for 401(k) plan withdrawals No provision. Written spousal consent required; without such consent, distributions could be made only in the form of periodic payments. Limitation on 401(k) investment No provision. Employees generally could not be required to invest more than 10% of salary reductions in employer stock or employer real property. Simplified foreign tax credit Special tax form no longer required for most shareholders to take the foreign tax credit. Same as House bill. Passive Foreign Investment Companies PFIC shareholders (including mutual funds) could elect to realize gains annually (thus avoiding anti-referral penalties under present law). Same as House bill. We will keep you informed as this issue develops. Matthew P. Fink President

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