The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

March 7, 2002

Joint Institute, SIA Letter Urging State Officials to Make Tax Code Changes, March 2002

March 7, 2002

The Honorable Frank O'Bannon
Governor
Office of the Governor
206 State House
Indianapolis, Indiana 46204

Re: State Conformity with Federal Changes for Retirement Security

Dear Governor O'Bannon:

On behalf of their members, the Investment Company Institute 1 and the Securities Industry Association 2 urge the Indiana General Assembly to adopt promptly changes to its state tax (Code) in order to bring the Code's retirement security and education savings provisions into conformity with the changes made to the Internal Revenue Code, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Conformity with these federal changes is necessary for the mutual fund and securities industries to continue to assist our millions of individual clients in meeting their retirement and education savings and other long-term financial needs.

The Institute and the SIA strongly supported the enactment of the retirement and education provisions of EGTRRA as enhancing retirement and education savings opportunities for all Americans. Under these provisions, many of which became available this year, Americans can increase their savings through liberalized contribution and taxation rules, 3 and retain their accumulated retirement savings in retirement vehicles through more flexible rollover rules. In the majority of states, the tax changes in EGTRRA have been automatically incorporated into corresponding state income tax provisions. Indiana, however, is among the minority of states where Indiana residents cannot take full advantage of these savings opportunities, because the state Code in its current form does not permit either the increased contributions or the expanded rollover opportunities. We therefore support prompt action to remedy the state Code's nonconformity with EGTRRA.

The consequences of nonconformity are particularly severe in the context of tax-qualified retirement plans. EGTRRA has dramatically enhanced the retirement savings potential of

American workers. This is particularly true for those Americans who are age 50 and over, because of the availability of “catch-up” contributions under section 401(k) plans, which allow extra contributions by those close to retirement age. 4

The nonconformity of the state Code may discourage Indiana employers from offering increased savings opportunities, such as catch-up provisions, however, because of the significant administrative burdens that would arise from differing state and federal tax treatment. For example, certain employee contributions (and certain rolled-over amounts) that are excludible from current income under federal law would be included in income for state income tax purposes. This would require a bifurcated tax reporting system 5 that would be costly to set up and maintain. Such a system might also preclude employers from using the combined federal-state reporting system, resulting in higher costs for employers and the state.

Employees will face greater confusion and complexity in preparing their taxes if their state treats their federally pre-tax retirement contributions as taxable. This could increase employees’ costs for state tax compliance, as well as lead to large-scale non-compliance, which in turn would increase the state’s costs of monitoring and enforcing its state tax Code. Employees may also overpay state taxes when they ultimately receive distributions from their plans upon retirement, unless they maintain adequate records, perhaps for decades. 6

The resulting higher costs to employers in connection with plan administration, recordkeeping and employee communications ultimately may prompt employers to reduce the benefits that they provide to employees. At a minimum, these employers may elect not to offer the enhanced retirement savings opportunities under EGTRRA to their employees.

In light of the advantages of increased retirement and education savings and the disadvantages of inconsistent tax treatment described above, we urge you to amend the state tax Code as soon as possible to conform with EGTRRA. Please contact Kathy Ireland at the Institute at (202) 371-5432 or Kim Chamberlain at the SIA at (212) 720-0611 if we can be of any assistance in connection with these efforts.

Sincerely,

Kathy D. Ireland
Associate Counsel
Investment Company Institute

Kim Chamberlain
Vice President and Counsel,
State Government Affairs
Securities Industry Association

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 9,039 open-end investment companies (“mutual funds”), 486 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.951trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders. Mutual funds function as the investment medium for employer-sponsored

retirement programs, including section 401(k) plans and section 403(b) arrangements, as well as for individual savings vehicles such as the traditional and Roth IRAs. As of December 31, 2000, mutual funds held about $2.4 trillion in retirement assets, including $1.2 trillion in qualified retirement plans. "Mutual Funds and the Retirement Market in 2000," ICI Fundamentals, Vol. 10, No. 2, June 2001.

2 The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 80-million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated $198 billion in U.S. revenue and $358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States. (More information about SIA is available on its home page: http://www.sia.com.)

3 In the case of education savings, for example, EGTRRA amended section 529 of the Internal Revenue Code to provide that distributions from qualified tuition programs used for qualified higher education expenses are excludible from gross income. In addition, the annual contribution limit applicable to Education IRAs (now known as Coverdell Education Savings Account) has been increased from $500 to $2,000 per designated beneficiary.

4 EGTRRA also permits catch-up contributions to 403(b) plans, governmental plans, and IRAs.

5 In fact, the system might have to incorporate more than two tax reporting regimes if the employer's workforce is drawn from more than one state.

6 These burdens upon individual employees would also apply in the context of their IRAs. The increased contribution and rollover opportunities under EGTRRA that are not incorporated into their state codes will produce the same confusion and complexity, and the potential for overpayment of state taxes when they receive distributions upon retirement. Federal and state law disparities in the context of section 529 qualified tuition programs would produce similar burdens on individual taxpayers.
