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PARENT AND STUDENT SAVINGS ACCOUNT PLUS ACT

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Mr. ROTH, from the Committee on Finance,
submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany S. 1133]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to which was referred the bill (S. 1133) to amend the Internal Revenue Code of 1986 to allow tax-free expenditures from education individual retirement accounts for elementary and secondary school expenses and to increase the maximum annual amount of contributions to such account, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

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I. LEGISLATIVE BACKGROUND AND SUMMARY

A. Legislative Background

The Senate Committee on Finance marked up S. 1133 ("Parent and Student Savings Account PLUS Act") on February 10, 1998. The Committee adopted an amendment in the nature of a substitute offered by Chairman Roth, and ordered the bill, as amended, favorably reported by a roll call vote of 11 yeas and 8 nays.

B. Summary

Education tax incentives (Title I)

The bill temporarily increases the annual contribution limit for education IRAs from $500 to $2,000, expands the definition of qualified education expenses to include qualified elementary and secondary education expenses, allows education IRA contributions for special needs beneficiaries above age 18, allows corporations and other entities to contribute to education IRAs, and makes certain technical corrections to the education IRA provisions. The provisions modifying education IRAs generally are effective for taxable years beginning after December 31, 1998. However, the provision that increases the annual contribution limit for education IRAs (i.e., to $2,000 per year) applies during the period January 1, 1999, through December 31, 2002, and the provision that expands the definition of qualified education expenses to include qualified elementary and secondary education expenses applies to contributions (and earnings thereon) made during the period January 1, 1999, through December 31, 2002. The technical correction provisions are effective as if enacted as part of the Taxpayer Relief Act of 1997.

The bill provides an exclusion from gross income for distributions from qualified State tuition programs to the extent the distribution is used to pay for college and vocational school tuition, fees, tutoring, books, supplies, equipment and special needs services and room and board expenses in cases where the student is at least a half-time student. The provision is effective for distributions made in taxable years beginning after December 31, 1998.

The bill expands the section 127 exclusion from gross income for employer-provided educational assistance so that the exclusion also is available for graduate courses beginning after December 31, 1997. The bill also extends the exclusion for two years (for both graduate and undergraduate courses), so that it expires with respect to courses beginning after December 31, 2002.

The bill increases the small issuer exception to $15 million, provided that at least $10 million of the bonds are issued to finance public schools. The provision applies to bonds issued in calendar years beginning after December 31, 1998.

The bill revises the tax treatment of National Health Corps Scholarships so that such scholarships are excluded from gross income under section 117, without regard to whether the recipient is obligated to later provide medical services in a geographic area or in an underserved population group or designated facility identified by the Public Health service as having a shortage of health care professionals. The exclusion does not apply to amounts received for regular living expenses, such as room and board. The provision applies to amounts received in taxable years beginning after December 31, 1993.

Revenue offsets (Title II)

The bill provides for two revenue offsets to pay for the abovementioned provisions: (1) the *Schmidt Baking* case with respect to vacation pay is overruled, effective for taxable years ending after the date of enactment; and (2) the carryback period for excess foreign tax credits is reduced from two years to one year, and the carryforward period for excess foreign tax credits is extended from five years to seven years, effective for foreign tax credits arising in taxable years beginning after December 31, 1999.

II. EXPLANATION OF THE BILL

A. Tax Incentives for Education (Title I)

1. Modifications to education IRAs (sec. 101 of the bill and sec. 530 of the Code)

Present Law

In general.—Section 530 provides tax-exempt status to "education IRAs," meaning certain trusts (or custodial accounts) which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a named beneficiary.[1] Contributions to education IRAs may be made only in cash. Annual contributions to education IRAs may not exceed $500 per designated beneficiary (except in cases involving certain tax-free rollovers, as described below), and may not be made after the designated beneficiary reaches age 18.[2] Moreover, section 4973 imposes a penalty excise tax if a contribution is made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary. These provisions were enacted as part of the Taxpayer Relief Act of 1997 ("1997 Act").

Phase-out of contribution limit.—The $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any other individual.

Treatment of distributions.—Amounts distributed from education IRAs are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of the designated beneficiary incurred during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed under sec. 25A with respect to the beneficiary for the same taxable year).[3] If a HOPE credit or Lifetime Learning credit is claimed with respect to a student for a taxable year, then a distribution from an education IRA may (at the

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[1] Education IRAs generally are not subject to Federal income tax, but are subject to the unrelated business income tax ("UBIT") imposed by section 511.

[2] An excise tax penalty may be imposed under present-law section 4973 to the extent that excess contributions above the $500 annual limit are made to an education IRA. However, Title VI of H.R. 2676, the Tax Technical Corrections Act of 1997, as passed by the House on November 5, 1997, clarifies that neither the excise tax penalty under section 4973 nor the additional 10-percent tax under section 530(d)(4) (described *infra*) may be imposed in cases where contributions (and any earnings thereon) are distributed from the education IRA before the date that a return is required to be filed (including extensions of time) by the beneficiary for the year in which the contribution was made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

[3] The exclusion will not be a preference item for alternative minimum tax (AMT) purposes.

option of the taxpayer) be made during that taxable year on behalf of that student, but an exclusion is *not* available under the Act for the earnings portion of such distribution.[4]

Distributions from an education IRA generally are deemed to consist of distributions of principal (which, under all circumstances, are excludable from gross income) and earnings (which *may* be excludable from gross income) by applying the ratio that the aggregate amount of contributions to the account for the beneficiary bears to the total balance of the account.[5] If the qualified higher education expenses of the student for the year are at least equal to the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the earnings in their entirety will be excludable from gross income. If, on the other hand, the qualified higher education expenses of the student for the year are *less than* the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the qualified higher education expenses will be deemed to be paid from a prorata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings will be excludable under section 530 (i.e., a portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings will be includible in the distributee's gross income.[6] To the extent that a distribution exceeds qualified higher education expenses of the designated beneficiary, an additional 10-percent tax is imposed on the earnings portion of such excess distribution under section 530(d)(4), unless such distribution is made

[4] If a HOPE credit or Lifetime Learning credit was claimed with respect to a student for an earlier taxable year, the exclusion provided for by section 530 may be claimed with respect to the same student for a *subsequent* taxable year with respect to a distribution from an education IRA made in that subsequent taxable in order to cover qualified higher education expenses incurred during that year. Conversely, if an exclusion is claimed for a distribution from an education IRA with respect to a particular student, then a HOPE credit or Lifetime Learning credit will be available in a subsequent taxable year with respect to that same student (provided that no exclusion is claimed in such other taxable years for distributions from an education IRA on behalf of that student and provided that the requirements of the HOPE credit or Lifetime Learning credit are satisfied in the subsequent taxable year).

[5] Title VI of H.R. 2676, the Tax Technical Corrections Act of 1997, as passed by the House on November 5, 1997, clarifies that, under rules contained in present-law section 72, distributions from education IRAs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account, and also makes certain conforming changes to section 72. In particular, the Tax Technical Corrections Act of 1997 provides that, under section 72(e)(8)(B), the determination of the ratio that the aggregate amount of contributions to an education IRA bears to the account balance is to be made at the time of the distribution or at such other time as the Secretary of the Treasury may prescribe.

[6] For example, if an education IRA has a total balance of $10,000, of which $4,000 represents principal (i.e., contributions) and $6,000 represents earnings, and if a distribution of $2,000 is made from such an account, then $800 of that distribution will be treated as a return of principal (which under no event is includible in the gross income of the distributee) and $1,200 of the distribution will be treated as accumulated earnings. In such a case, if qualified higher education expenses of the beneficiary during the year of the distribution are at least equal to the $2,000 total amount of the distribution (i.e., principal plus earnings), then the entire earnings portion of the distribution will be excludible under section 530, provided that a Hope credit or Lifetime Learning credit is not claimed for that same taxable year on behalf of the beneficiary. If, however, the qualified higher education expenses of the beneficiary for the taxable year are less than the total amount of the distribution, then only a portion of the earnings will be excludable from gross income under section 530. Thus, in the example discussed above, if the beneficiary incurs only $1,500 of qualified higher education expenses in the year that a $2,000 distribution is made, then only $900 of the earnings will be excludable from gross income under section 530 (i.e., an exclusion will be provided for the pro-rata portion of the earnings, based on the ratio that the $1,500 of qualified higher education expenses bears to the $2,000 distribution) and the remaining $300 of the earnings portion of the distribution will be includible in the distributee's gross income.

on account of the death or disability of, or scholarship received by, the designated beneficiary.[7]

Section 530(d) allows tax-free (and penalty-free) transfers or roll-overs of account balances from one education IRA benefiting one beneficiary to another education IRA benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.[8]

The legislative history to the 1997 Act indicates that any balance remaining in an education IRA will be deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).[9]

Qualified higher education expenses.—The term "qualified higher education expenses" includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. Moreover, the term "qualified higher education expenses include room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, section 530(b)(2)(B) specifically provides that qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127. In addition, qualified higher education expenses do not include expenses paid with amounts that are excludible under section 135. No reduction of qualified higher education expenses is required,

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[7] A technical correction is needed to section 530(d)(4) to clarify that the 10-percent additional tax should not be imposed in cases where a distribution (although used to pay for qualified higher education expenses) is includible in gross income because the taxpayer elects the HOPE or Lifetime Learning credit on behalf of the student for the same taxable year.

[8] For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons. A technical correction is needed to section 529(e)(2) to clarify that a member of the family includes the spouse of the original beneficiary.

[9] A technical correction providing that any balance remaining in an education IRA will be deemed distributed within 30 days after the date that the designated beneficiary reaches age 30 is included in Title VI of H.R. 2676, the Tax Technical Corrections Act of 1997, as passed by the House on November 5, 1997.

however, for a gift, bequest, devise, or inheritance within the meaning of section 102(a).

Eligible educational institution.—Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Reasons for Change

The Committee believes that the present-law rules governing education IRAs should be expanded to provide a greater incentive for families (and other persons) to save for educational purposes, including for expenses related to elementary and secondary school education. The Committee also believes that more flexible rules are needed for education IRAs established for the benefit of special needs students.

Explanation of Provisions

Annual contribution limit.—For the period 1999 through 2002, the bill increases to $2,000 the annual contribution limit that currently applies to education IRAs under section 530(b)(1)(A)(iii). Thus, under the bill, aggregate contributions that could be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary would be limited to $2,000 for each year during the period 1999 through 2002. For 2003 and later years, the annual contribution limit for education IRAs will be $500.

Qualified expenses.—With respect to contributions made during the period 1999 through 2002 (and earnings attributable to such contributions), the bill expands the definition of qualified education expenses that may be paid with tax-free distributions from an education IRA. Specifically, the definition of qualified education expenses is expanded to include "qualified elementary and secondary education expenses" meaning (1) tuition, fees, academic tutoring [10], special needs services, books, supplies, and equipment (including computers and related software and services) incurred *in connection with* the enrollment or attendance of the designated beneficiary as an elementary or secondary student at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12), and (2) room and board, uniforms, transportation, and supplementary items and services (including extended-day programs) *required or provided by* such a school for such enrollment or attendance of the designated beneficiary. "Qualified elementary and secondary education expenses" also include certain homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling. For contributions made in 2003 or later years

[10] For this purpose, it is intended that "academic tutoring" means additional, personalized instruction provided in coordination with the student's academic courses.

(and for earnings attributable to such contributions), the definition of qualified education expenses will be limited to post-secondary education expenses. [11]

Under the bill, no deduction or credit (such as the dependent care credit under section 21) will be allowed under the Internal Revenue Code for any qualified education expenses taken into account in determining the amount of the exclusion under section 530 for a distribution from an education IRA.

With respect to post-secondary education, qualified education expenses include (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred in connection with the enrollment or attendance of the designated beneficiary at an eligible post-secondary educational institution, and (2) room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution calculating costs of attendance for Federal financial aid programs) for any period during which the student is at least a half-time student.

Special needs beneficiaries.—The bill also provides that, although contributions to an education IRA generally may not be made after the designated beneficiary reaches age 18, contributions may continue to be made to an education IRA in the case of a special needs beneficiary (as defined by Treasury Department regulations). In addition, under the bill, in the case of a special needs beneficiary, a deemed distribution of any balance in an education IRA will *not* be required when the beneficiary reaches age 30. [12]

Contributions by persons other than individuals.—The bill clarifies that corporations and other entities (e.g., tax-exempt entities) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution. As under present law, the eligibility of high-income *individuals* to make contributions to education IRAs is phased out ratably for individuals with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns).

Technical corrections.—The bill provides for several technical corrections to section 530 (as enacted as part of the Taxpayer Relief Act of 1997), including: (1) adding a provision that any balance remaining in an education IRA will be deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30; (2) clarifying that, under rules contained in present-law section 72, distributions from education IRAs are treated as representing a pro-rata share of the principal and accumulated earnings in the account; and (3) clarifying that, under section 530(d)(4), the 10-percent additional tax will not be imposed in cases where a distribution (although used to pay for qualified higher education expenses)

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[11] To the extent a taxpayer incurs "qualified elementary and secondary expenses" during any year that a distribution is made from an education IRA, the distribution will be deemed to first consist of a distribution of any contributions (and earnings thereon) that were made to the education IRA during the period 1999–2002 (reduced by the amount of such contributions and earnings that were deemed to be distributed in prior taxable years). The bill requires that trustees of education IRAs will be required to keep separate accounts with respect to contributions made during the period 1999-2002 (and earnings thereon).

[12] The determination of whether a beneficiary has "special needs" will be required to be made for each year that contributions are made to an education IRA after the beneficiary reaches age 18. However, if an individual meets the definition of a "special needs" beneficiary when such individual reaches age 30, then such individual thereafter will be presumed to be a "special needs" beneficiary.

is includible in gross income solely because the taxpayer elects the HOPE or Lifetime Learning credit on behalf of the student for the same taxable year.

Effective Date

The provisions modifying education IRAs under section 530 generally are effective for taxable years beginning after December 31, 1998. However, the provision that increases the annual contribution limit for education IRAs (i.e., to $2,000 per year) applies during the period January 1, 1999, through December 31, 2002, and the provision that expands the definition of qualified education expenses to include qualified elementary and secondary education expenses applies to contributions (and earnings thereon) made during the period January 1, 1999, through December 31, 2002. The technical correction provisions are effective as if enacted as part of the Taxpayer Relief Act of 1997 (i.e., such provisions are effective for taxable years beginning after December 31, 1997).

2. Exclusion from gross income of education distributions from qualified State tuition programs (sec. 102 of the bill and sec. 529 of the Code)

Present Law

Section 529 provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. The term "qualified higher education expenses" has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution [13], as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.

Section 529 also provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts dis-

[13] "Eligible educational institutions" are defined the same for purposes of education IRAs (described in II.A.1., above) and qualified State tuition programs.

tributed to a contributor or another distributee (e.g., when a parent receives a refund) will be included in the contributor's/distributee's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.[14]

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.[15] Contributors and beneficiaries are not allowed to directly or indirectly direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefiting one designated beneficiary to another account benefiting a different beneficiary will be considered a distribution (as will a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family.[16] Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

No amount is includible in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any contribution to or earnings on such a program until a distribution is made from the program, at which time the earnings portion of the distribution (whether made in cash or in-kind) will be includible in the gross income of the distributee. However, to the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f))(1)), the distributee (or another taxpayer claiming the distributee as a dependent) will be able to claim the HOPE credit or Lifetime Learning credit under section 25A with respect to such

[14] Title VI of H.R. 2676, the Tax Technical Corrections Act of 1997, as passed by the House on November 5, 1997, clarifies that, under rules contained in present-law section 72, distributions from qualified State tuition programs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account, and also makes certain conforming changes to section 72. In particular, the Tax Technical Corrections Act of 1997 provides that, under section 72(e)(8)(B), the determination of the ratio that the aggregate amount of contributions to a qualified State tuition program on behalf of a beneficiary bears to the total balance (or value) of the account for the beneficiary is to be made at the time of the distribution or at such other time as the Secretary of the Treasury may prescribe.

[15] Sections 529(c)(2), (c)(4), and (c)(5), and section 530(d)(3) provide special estate and gift tax rules for contributions made to, and distributions made from, qualified State tuition programs and education IRAs.

[16] For this purpose, the term "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons. A technical correction is needed to section 529(e)(2) to clarify that a member of the family includes the spouse of the original beneficiary.

tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phaseout for those credits does not apply).

Reasons for Change

The Committee believes that distributions from qualified State tuition programs should not be subject to Federal income tax to the extent that such distributions are used to pay for qualified higher education expenses of an undergraduate or graduate student who is attending a college, university, or certain vocational schools.

Explanation of Provision

Under the bill, an exclusion from gross income is provided for distributions from qualified State tuition programs (as defined in sec. 529) to the extent that the distribution is used to pay for (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred *in connection with* the enrollment or attendance of a designated beneficiary at an eligible post-secondary educational institution (i.e., colleges, universities, and certain vocational schools), *and* (2) room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution calculating costs of attendance for Federal financial aid programs) for any period during which the student is at least a half-time student. As under present law, there is no specific dollar limitation imposed under the Internal Revenue Code on contributions made to qualified State tuition programs, although section 529(b)(7) will continue to require that the programs themselves provide adequate safeguards to prevent contributions on behalf of a beneficiary in excess of those necessary to provide for qualified higher education expenses of the beneficiary.

As with the present-law exclusion from gross income for distributions from education IRAs, the tax-free treatment for a distribution from a qualified State tuition program will be allowed only if, for the taxable year during which the distribution is made, a HOPE or Lifetime Learning credit (under sec. 25A) is not claimed on behalf of the student. As under present law, if a student is claimed as a dependent by his or her parent, then the parent (if eligible) must decide whether to elect to claim a HOPE or Lifetime Learning credit with respect to that student for that taxable year; and, if the parent elects to claim a HOPE or Lifetime Learning credit, then the earnings portion of a distribution made to a student from a qualified State tuition program will be includible in the gross income of the student.

Under the bill, no deduction (under section 162 or any other section) or credit will be allowed under the Internal Revenue Code for any qualified higher education expenses taken into account in determining the amount of the exclusion under section 529 for a distribution made to, or on behalf of, a student by a qualified State tuition program.

Effective Date

The provision that allows an exclusion from gross income for certain distributions from qualified State tuition programs under section 529 (and the modification to the definition of qualified higher education expenses under that section) is effective for distributions made in taxable years beginning after December 31, 1998.

3. Extension of exclusion for employer-provided education assistance (sec. 103 of the bill and sec. 127 of the Code)

Present Law

Under present-law section 127, an employee's gross income and wages do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts are paid or incurred to an educational assistance program that meets certain requirements. This exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year. The exclusion does not apply with respect to graduate-level courses. The exclusion is scheduled to expire with respect to courses beginning after May 31, 2000.

In the absence of the exclusion provided by section 127, educational assistance is excludable from income only if the education is related to the employee's current job, meaning that the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (but not if the education relates to certain minimum educational requirements or enables a taxpayer to begin working in a new trade or business).

Reasons for Change

The Committee believes that the exclusion for employer-provided educational assistance has enabled millions of workers to advance their education and improve their job skills without incurring additional taxes and a reduction in take-home pay. In addition, the exclusion lessens the complexity of the tax laws. Without the special exclusion, a worker receiving educational assistance from his or her employer is subject to tax on the assistance, unless the education is related to the workers' current job. Because the determination of whether particular educational assistance is job-related is based on the facts and circumstances, it may be difficult to determine with certainty whether the educational assistance is excludable from income. This uncertainty may lead to disputes between taxpayers and the Internal Revenue Service.

The Committee believes that reinstating the exclusion for graduate-level employer-provided educational assistance will enable more individuals to seek higher education, and that further extension of the exclusion is important. The past experience of allowing the exclusion to expire and subsequently retroactively extending it has created burdens for employers and employees. Employees may have difficulty planning for their educational goals if they do not know whether their tax bills will increase. For employers, the fits

and starts of the legislative history of the provision have caused severe administrative problems. Uncertainty about the exclusion's future may discourage some employers from providing educational benefits.

Explanation of Provision

The bill reinstates the exclusion for graduate-level courses, effective with respect to courses beginning after December 31, 1997. In addition, the bill provides that the exclusion (as applied to both graduate and undergraduate courses) expires with respect to courses beginning after December 31, 2002.

Effective Date

The extension of the exclusion for employer-provided educational assistance to graduate-level courses is effective for expenses with respect to courses beginning after December 31, 1997. The exclusion (with respect to both graduate and undergraduate courses) expires with respect to courses beginning after December 31, 2002.

4. Increase in arbitrage rebate exception for governmental bonds used to finance education facilities (sec. 104 of the bill and sec. 148 of the Code)

Present Law

Interest on State and local government bonds generally is excluded from income if the bonds are issued to finance activities carried out and paid for with revenues of these governments. Interest on bonds issued by these governments to finance activities of other persons (e.g. private activity bonds) is taxable unless a specific exception is included in the Code. In the case of bonds, the interest on which is excluded from income, generally, all arbitrage profits earned on investments unrelated to the purpose of the borrowing ("nonpurpose investments") must be rebated to the Federal Government. An exception (the "small issuer exception") allows governmental units having general taxing powers to issue up to $5 million of governmental bonds during a calendar year without being subject to the arbitrage rebate requirement. This limit is increased to $10 million for governmental units that issue at least $5 million of public school bonds during the calendar year.

Reasons for Change

The Committee believes that additional Federal assistance for the construction of public schools is appropriate in light of currently identified national needs. The Committee determined a modest increase in the small issuer exception for bonds to finance public school construction will assist local governments in meeting these needs by simplifying their use of tax-exempt financing without creating incentives to issue such debt earlier or in larger amounts than necessary.

Explanation of Provision

The bill increases the small issuer exception to $15 million, provided that at least $10 million of the bonds are issued to finance public schools.

Effective Date

The provision applies to bonds issued in calendar years beginning after December 31, 1998.

5. Exclusion of certain amounts received under the National Health Corps Scholarship program (sec. 105 of the bill and sec. 117 of the Code)

Present Law

Section 117 excludes from gross income amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarship, section 117 provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations.

Section 117(c) specifically provides that the exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

Reasons for Change

The Committee believes that it is appropriate to provide tax-free treatment under section 117 for scholarships received by medical, dental, nursing, and physician assistant students under the National Health Corps Scholarship Program.

Explanation of Provision

Under the bill, amounts received by an individual under the National Health Corps Scholarship Program—administered under section 338A(g)(1)(A) of the Public Health Service Act—are eligible for tax-free treatment as a qualified scholarship under section 117, without regard to the fact that the recipient of the scholarship is obligated to later provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students to cover regular living expenses, such as room and board.

Effective Date

The provision applies to amounts received in taxable years beginning after December 31, 1993.

B. Revenue Offsets (Title II)

1. Employer deduction for vacation pay (sec. 201 of the bill and sec. 404 of the Code)

Present Law

For deduction purposes, any method or arrangement that has the effect of a plan deferring the receipt of compensation or other benefits for employees is treated as a deferred compensation plan (sec. 404(b)). In general, contributions under a deferred compensation plan (other than certain pension, profit-sharing and similar plans) are deductible in the taxable year in which an amount attributable to the contribution is includable in income of the employee. However, vacation pay which is treated as deferred compensation is deductible for the taxable year of the employer in which the vacation pay is paid to the employee (sec. 404(a)(5)).

Temporary Treasury regulations provide that a plan, method, or arrangement defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed. A plan, method or arrangement is presumed to defer the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the 3rd calendar month after the end of the employer's taxable year in which the related services are rendered (the "2½ month" period). A plan, method or arrangement is not considered to defer the receipt of compensation or benefits for more than a brief period of time after the end of the employer's taxable year to the extent that compensation or benefits are received by the employee on or before the end of the applicable 2½ month period. (Temp. Treas. Reg. sec. 1.404(b)–1T A–2).

The Tax Court recently addressed the issue of when vacation pay and severance pay are considered deferred compensation in *Schmidt Baking Co., Inc.*, 107 T.C. 271 (1996). In *Schmidt Baking*, the taxpayer was an accrual basis taxpayer with a fiscal year that ended December 28, 1991. The taxpayer funded its accrued vacation and severance pay liabilities for 1991 by purchasing an irrevocable letter of credit on March 13, 1992. The parties stipulated that the letter of credit represented a transfer of substantially vested interest in property to employees for purposes of section 83, and that the fair market value of such interest was includable in the employees' gross incomes for 1992 as a result of the transfer.[17] The Tax Court held that the purchase of the letter of credit, and the resulting income inclusion, constituted payment of the vacation and severance pay within the 2½ month period. Thus, the vacation and

[17] While the rules of section 83 may govern the income inclusion, section 404 governs the deduction if the amount involved is deferred compensation.

severance pay were treated as received by the employees within the 2½ month period and were not treated as deferred compensation. The vacation pay and severance pay were deductible by the taxpayer for its 1991 fiscal year pursuant to its normal accrual method of accounting.

Reasons for Change

Prior to the Tax Reform Act of 1986, an employer could make an election to deduct an amount representing a reasonable addition to a reserve account for vacation pay earned by employees before the close of the current year and expected to be paid by the close of that year or within 12 months thereafter. As a result of concerns that this rule provided more favorable tax treatment for vacation pay than other types of compensation or deductible items, the Tax Reform Act of 1986 limited this special rule to vacation pay that is paid during the current taxable year or within 8½ months after the close of the taxable year of the employer with respect to which the vacation pay was earned by employees.

The tax treatment of vacation pay was again changed in the Omnibus Budget Reconciliation Act of 1987 ("OBRA 1987"). At that time, the Congress was concerned that then-present law provided more favorable tax treatment for vacation pay that was deferred by employees beyond the end of the year than was provided for other deferred benefits. The House and Senate bills would have repealed the reserve for accrued vacation pay and would have provided that deductions for vacation pay generally would be allowed in any taxable year for amounts paid during the year, plus vested vacation amounts paid or funded within 2½ months after the end of the year. The conference agreement followed a different approach, and provided that "vacation pay earned during any taxable year, but not paid to employees on or before the date that is 2½ months after the end of the taxable year, is deductible for the taxable year of the employer in which it is paid to employees."[18] The key difference between the House and Senate provisions and the conference agreement to OBRA 1987 is that the conference agreement does not allow a deduction for amounts merely because they are vested and funded (i.e., are includable in income) within 2½ months after the end of the employer's taxable year.

The Committee believes that the decision in *Schmidt Baking* reaches an inappropriate result and represents an incorrect interpretation of the intent of the Congress in adopting the vacation pay provision in OBRA 1987. The Committee believes that the intent of that provision was clearly to provide that a deduction for vacation pay is not available for the current taxable year unless the vacation pay is actually paid to employees within 2½ months after the end of the year. Moreover, OBRA 1987 reflect Congressional intent and understanding that compensation actually paid beyond the 2½ month period is deferred compensation.

Further, the Committee is concerned that taxpayers may inappropriately extend the rationale of *Schmidt Baking* to other situations in which a deduction or other tax consequences are contingent upon an item being paid. The Committee does not believe

[18] H. Rept. 100–495, at 921 (December 21, 1987).

that, as a general rule, letters of credit and similar mechanisms should be considered payment for any purposes of the Code.

Explanation of Provision

The bill provides that, for purposes of determining whether an item of compensation (other than severance pay),[19] is deferred compensation (under Code sec. 404), the compensation is not considered to be paid or received until actually received by the employee. In addition, an item of deferred compensation is not considered paid to an employee until actually received by the employee. The bill is intended to overrule the result in *Schmidt Baking.* For example, with respect to the determination of whether vacation pay is deferred compensation, the fact that the value of the vacation pay is includible in the income of employees within the applicable 2½ month period is not relevant. Rather, the vacation pay must have been actually received by employees within the 2½ month period in order for the compensation not to be treated as deferred compensation.

It is intended that similar arrangements, in addition to the letter of credit approach used in *Schmidt Baking*, do not constitute actual receipt by the employee, even if there is an income inclusion. Thus, for example, actual receipt does not include the furnishing of a note or letter or other evidence of indebtedness of the taxpayer, whether or not the evidence is guaranteed by any other instrument or by any third party. As a further example, actual receipt does not include a promise of the taxpayer to provide service or property in the future (whether or not the promise is evidenced by a contract or other written agreement). In addition, actual receipt does not include an amount transferred as a loan, refundable deposit, or contingent payment. Amounts set aside in a trust for employees generally are not considered to be actually received by the employee.

The bill does not change the rule under which deferred compensation (other than vacation pay and deferred compensation under qualified plans) is deductible in the year includible in the gross income of employees participating in the plan if separate accounts are maintained for each employee.

While *Schmidt Baking* involved only vacation pay and severance pay, there is concern that this type of arrangement may be tried to circumvent other provisions of the Code where payment is required in order for a deduction to occur. Thus, it is intended that the Secretary will prevent the use of similar arrangements. No inference is intended that the result in *Schmidt Baking* is present law beyond its immediate facts or that the use of similar arrangements is permitted under present law.

The bill does not affect the determination of whether an item is includable in income. Thus, for example, using the mechanism in *Schmidt Baking* for vacation pay would still result in income inclusion to the employees, but the employer would not be entitled to a deduction for the vacation pay until actually paid to and received by the employees.

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[19] A provision that overrules *Schmidt Baking* with respect to severance pay was included in H.R. 2644, the "United States-Caribbean Trade Partnership Act," as ordered reported by the Committee on Ways and Means on October 9, 1997.

Effective Date

The provision is effective for taxable years ending after the date of enactment. Any change in method of accounting required by the bill is treated as initiated by the taxpayer with the consent of the Secretary of the Treasury. Any adjustment required by section 481 as a result of the change will be taken into account in the year of the change.

2. Modifications to foreign tax credit carryover period (sec. 202 of the bill and sec. 904 of the Code)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate foreign tax credit limitations are applied to specific categories of income.

The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and forward five years. The amount carried over may be used as a credit in a carryover year to the extent the taxpayer otherwise has excess foreign tax credit limitation for such year. The separate foreign tax credit limitations apply for purposes of the carryover rules.

Reasons for Change

The Committee believes that reducing the carryback period for foreign tax credits to one year and increasing the carryforward period to seven years will reduce some of the complexity associated with carrybacks while continuing to address the timing difference between U.S. and foreign tax rules.

Explanation of Provision

The bill reduces the carryback period for excess foreign tax credits from two years to one year. The bill also extends the excess foreign tax credit carryforward period from five years to seven years.

Effective Date

The provision applies to foreign tax credits arising in taxable years beginning after December 31, 1999.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of S. 1133 as reported.

Estimated Budget Effects of S. 1133 (The "Parent and Student Savings Account Plus Act"), as Approved by the Senate Committee on Finance Fiscal Years 1998–2008

[Millions of Dollars]

Provision	Effective	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1998–2003	1998–2008
A. Tax Incentives for Education (Title I)														
1. Education IRAs—increase the annual contribution limit to $2,000; expand the definition of qualified education expenses to include qualified elementary and secondary education expenses (including after-school programs); allow education IRA contributions for special needs beneficiaries above the age of 18; allow corporations and other entities to contribute to education IRAs; and various technical corrections (sunsets 12/31/92)	tyba 12/31/98	....	−33	−110	−164	−216	−238	−215	−204	−186	−158	−119	−762	−1,644
2. Qualified State tuition programs	dmi tyba 12/31/98	....	−12	−47	−68	−92	−120	−154	−193	−239	−291	−352	−339	−1,568
3. Expand the section 127 exclusion for employer-provided educational assistance to include graduate 0 level courses; extend the exclusion for undergraduate-level courses (both provisions sunset 12/31/02)	(11)	−107	−291	−378	−603	−760	−488	....	....	....	....	....	−2,627	−2,627
4. Raise the small issuer arbitrage rebate exception to $15 million (for school construction only)	1/1/99	....	(2)	−3	−7	−11	−14	−27	−29	−32	−34	−37	−35	−194
5. National health Corps Scholarship exclusion	tyba 12/31/93	*Negligible Revenue Effect*												
Subtotal, Title I		**−107**	**−336**	**−538**	**−842**	**−1,079**	**−860**	**−396**	**−426**	**−457**	**−483**	**−508**	**−3,763**	**−6,033**

Estimated Budget Effects of S. 1133 (The "Parent and Student Savings Account Plus Act"), as Approved by the Senate Committee on Finance—Continued Fiscal Years 1998–2008

[Millions of Dollars]

Provision	Effective	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	1998–2003	1998–2008
B. Revenue Offsets (Title II)														
1. Repeal *Schmidt Baking* with respect to vacation pay	tyea DOE	513	970	986	120	126	132	139	146	153	161	169	2,847	3,615
2. Allow taxpayers to use foreign tax credits to reduce income for 1 year back and carry forward 7 years	ftpoai tyba 12/31/99	....	....	87	562	502	468	437	406	279	263	259	1,618	3,262
Subtotal, Title II		**513**	**970**	**1,073**	**682**	**628**	**600**	**576**	**552**	**432**	**424**	**428**	**4,465**	**6,877**
Net Total		**406**	**634**	**535**	**−160**	**−451**	**−260**	**180**	**126**	**−25**	**−59**	**−80**	**702**	**844**

[1] Effective for expenses paid with respect to courses beginning during the period 1/1/98 through 12/31/02 for graduate-level education and extends the exclusion for undergraduate education with respect to courses beginning during the period 6/1/00 through 12/31/02.

[2] Loss of less than $500,000.

Legend for "Effective" column: dmi = distributions made in; ftpoai = foreign taxes paid or accrued in; tyba = taxable years beginning after; tyea = taxable years ending after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the revenue provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the bill involve increased tax expenditures (see revenue table in Part III. A., above), and that the revenue offset provisions of the bill involve reduced tax expenditures (see Part III.A., above).

C. Consultation with Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office submitted the following statement on this bill:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 18, 1998.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed S. 1133, the "Parent and Student Savings Account PLUS Act." The JCT estimates that this bill would increase governmental receipts by $406 million in fiscal year 1998, and by $702 million over fiscal years 1998 through 2003. CBO concurs with the estimate.

For a detailed estimate of the S. 1133, please refer to the enclosed JCT table [see Part III.A.].

In accordance with the requirements of Public Law 104–4, the Unfunded Mandates Reform Act of 1995, JCT has determined that S. 1133 contains no federal intergovernmental mandates.

In addition, JCT has determined that the amendment contains two federal private sector mandates. The provisions to repeal Schmidt Baking with respect to the employer deduction for vacation pay, and to modify the foreign tax credit carryback and carryforward periods, are estimated to increase tax revenue by $3,615 million and $3,262 million, respectively, over fiscal years 1998 through 2008, which is the estimated amount that the private sector will be required to spend in order to comply with this federal private-sector mandate. The revenue raised from these provisions will offset the revenue cost of the education savings tax incentives in the bill.

Federal Private Sector Mandates

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	2003	1998–2003
Total Mandate Cost	513	970	1,073	682	628	600	4,466

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 establishes pay-as-you-go procedures for legislation affecting receipts or direct spending through 2008. For purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted. Because the bill would affect receipts, pay-as-you-go procedures would apply. These effects are summarized in the table below.

Pay-as-You-Go Considerations

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	2003	1998–2003
Changes in Receipts	406	634	535	−160	−451	−260	703
Changes in Outlays	(1)	(1)	(1)	(1)	(1)	(1)	(1)

[1] Not applicable.

If you wish further details, please feel free to contact me or your staff may wish to contact Alyssa Trzeskowski.

Sincerely,

JUNE E. O'NEILL, *Director.*

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of Rule XXVI of the standing rules of the Senate, the following statements are made concerning the roll call votes in the Committee's consideration of S. 1133.

Motion to report the bill

The bill (S. 1133) was ordered favorably reported, as amended by the Chairman's amendment in the nature of a substitute, by a roll call vote of 11 yeas and 8 nays on February 10, 1998. The vote, with a quorum present, was as follows:

Yeas.—Senators Roth, Grassley, Hatch, D'Amato, Murkowski (proxy), Nickles, Gramm, Lott, Mack (proxy), Breaux, and Graham.

Nays.—Senators Chafee, Moynihan, Baucus, Rockefeller, Conrad (proxy), Moseley-Braun, Bryan, and Kerry.

Votes on other amendments

(1) An amendment by Senator D'Amato to guarantee coverage of inpatient hospital care for breast cancer treatment was defeated on a roll call vote of 6 yeas and 6 nays. The chairman ruled this amendment non-germane. The vote was as follows (a vote of two-thirds of Members in attendance is required to overrule the Chairman's germaneness ruling):

Yeas.—Senators Hatch, D'Amato, Murkowski, Moynihan, Moseley-Braun, and Bryan.

Nays.—Senators Roth, Chafee, Gramm, Lott, Jeffords, and Baucus.

(2) A amendment by Senator Rockefeller to reduce the income phaseout limits on contributions to education IRAs for married couples from the current $110,000–$150,000 to $75,000–$95,000 was defeated by a roll call vote of 7 yeas and 12 nays. The vote was as follows:

Yeas.—Senators Moynihan, Baucus, Rockefeller, Conrad (proxy), Graham (proxy), Moseley-Braun, and Kerrey.

Nays.—Senators Roth, Chafee, Grassley, Hatch, D'Amato, Murkowski (proxy), Nickles (proxy), Gramm, Lott, Mack (proxy), Breaux, and Bryan.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as amended.

Impact on individuals and businesses

The bill increases the annual contribution limit for education IRAs from $500 to $2,000 (for taxable years beginning after 1998 and before 2003), expands the definition of qualified education expenses to include qualified elementary and secondary education expenses (including after-school programs), allows education IRA contributions for special needs beneficiaries above age 18, allows corporations and other entities to contribute to education IRAs, and makes certain technical corrections to the education IRA provisions.

The bill provides an exclusion from gross income for distributions from qualified State tuition programs to the extent the distribution is used to pay for college and vocational school tuition, fees, tutoring, books, supplies, equipment and special needs services and room and board expenses in cases where the student is at least a half-time student.

The bill expands the section 127 exclusion from gross income for employer-provided educational benefits so that the exclusion also is available for graduate courses, and extends the section 127 exclusion for two years (through 2002).

The bill increases the small issuer exception to the arbitrage rebate rules for certain tax-exempt school bonds from $10 million to $15 million.

The bill revises the tax treatment of National Health Corps Scholarships so that such scholarships are excluded from gross income under section 117, without regard to whether the recipient later is obligated to provide medical services in a geographic area or in an underserved population group or designated facility identified by the Public Health Service as having a shortage of health care professionals. The exclusion does not apply to amounts received for regular living expenses, such as room and board.

The bill provides for two revenue offsets to pay for the abovementioned provisions: (1) the *Schmidt Baking* case with respect to vacation pay is overruled, effective for taxable years ending after the date of enactment; and (2) the carryback period for excess foreign tax credits is reduced from two years to one year, and the carryforward period for excess foreign tax credits is extended from five years to seven years, effective for foreign tax credits arising in taxable years beginning after December 31, 1999.

The two revenue offset provisions will increase the tax burden on the affected taxpayers. The other provisions will reduce the tax burden on individuals utilizing educational IRAs, qualified State tuition programs, employer-provided educational assistance programs, and National Health Corps Scholarships. The increase in the arbitrage exception for public school bonds issued by certain State and local governments will reduce the burden for paying certain arbitrage rebates to the Federal Government.

Impact on personal privacy and paperwork

The bill should not have any adverse impact on personal privacy. By expanding the eligibility of qualified education expenses, the bill will result in certain additional taxpayers having to keep track of qualified elementary and secondary education expenses and special needs expenses in connection with maintaining education IRA records. The bill also clarifies that corporations and tax-exempt entities are permitted to make contributions to education IRAs. The bill makes certain technical corrections to the education IRA provisions to clarify the application of the provisions.

The expansion of the section 127 exclusion for employer-provided educational benefits to graduate courses will involve some additional recordkeeping concerning students taking graduate level courses.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (P.L. 104–4).

The Committee on Finance has reviewed the provisions of the bill (S. 1133) as approved by the Committee on February 10, 1998. In accordance with the requirements of Public Law 104–4, the Committee has determined that the following provisions of the bill contain Federal private sector mandates.

Restriction on employer deduction for certain vacation pay (overruling of *Schmidt Baking*) (bill sec. 201); and

Modification of foreign tax credit carryback and carryforward rules (bill sec. 202).

As indicated in the revenue table in (III.A., above), the vacation pay provision is estimated to increase tax revenue by $3,615 million over fiscal years 1998–2008, and the foreign tax credit provision is estimated to increase tax revenue by $3,262 million over fiscal years 1998–2008. These are the estimated amounts ($6,877 million total for the period, 1998–2008) that the private sector will be required to pay in order to comply with the Federal private sector mandates under the bill. These two provisions will not impose a Federal intergovernmental mandate on State, local, or tribal governments.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

VII. MINORITY VIEWS OF DANIEL PATRICK MOYNIHAN, MAX BAUCUS, JOHN D. ROCKEFELLER, KENT CONRAD, CAROL MOSELEY-BRAUN, RICHARD H. BRYAN, AND J. ROBERT KERREY

The undersigned Members of the Committee on Finance opposed the Parent and Student Savings Account Plus Act, as reported by the Finance Committee on February 10, 1998. We opposed the bill because, as explained below, we believe its central feature—the proposal to expand education savings accounts—is seriously flawed. We were also troubled by the Committee's failure to address in this bill the pressing need for improved school infrastructure in the states.

We believe that improving public education and increasing opportunities for education must continue to be one of our highest national priorities. Congress should therefore undertake a comprehensive review of Federal education policy rather than limiting such efforts to tinkering with the Internal Revenue Code.

Employer provided educational assistance

The bill includes an extension of Internal Revenue Code Section 127, employer provided educational assistance, which we strongly support. Section 127 is one of the most successful Federal education policies in place today. Approximately one million persons per year participate in employer educational assistance programs; about a quarter of those are enrolled in graduate-level courses. Employers benefit substantially from the ability to send employees to school to acquire additional skills. In a world of continuing education, where science and technology change constantly, Section 127 permits employers to provide education benefits to employees, who then bring new skills back into the workplace and earn more income. The Federal Treasury in turn receives more tax revenue. This is a program that works, and it administers itself.

Last year, approving the provision contained in the bill reported by the Finance Committee, the Senate version of the Taxpayer Relief Act of 1997 made Section 127 permanent for both undergraduate and graduate study. However, the Senate language was dropped in conference, leaving only undergraduate study eligible under the Code. We believe that the Committee has acted appropriately in once again seeking to extend the benefit of this provision to graduate students, and in extending the entire provision until December 31, 2002. We hope this position is sustained in the Senate bill, and in conference with the House.

Qualified State prepaid tuition plans

We are also pleased that the bill reported by the Committee includes a provision to expand the tax benefits accorded to qualified State prepaid tuition plans. These programs have been adopted by,

or are being considered in, each of the States, to provide a vehicle whereby parents and students can save for the costs of college. The Congress recognized the importance of these programs in the Small Business Job Protection Act of 1996 by enacting rules designed to clarify that the programs are tax-exempt and that the beneficiaries of the plans should not be taxed until funds are withdrawn from the plans. The prepaid tuition rules were further liberalized in the Taxpayer Relief Act of 1997.

The proposal in the Committee bill to exclude certain distributions from qualified State prepaid tuition plans from gross income would contribute to tax simplification. Parents and students would be able to participate in the programs and withdraw funds for college expenses without having to determine which portion of the withdrawal represents earnings versus a return of contributions, and whether a Hope Scholarship or Lifetime Learning credit is available with respect to the educational expenses paid by the program. The Committee bill would also eliminate the consequence of the differences in the law between the definition of "qualified higher education expenses" for purposes of prepaid tuition plans and the Hope Scholarship and Lifetime Learning tax credits.

Education savings accounts

We appreciate the good intentions of the proponents of expanding the availability of education savings accounts. However, the proposed changes to current law included in the Committee bill are fraught with serious policy and technical defects. The Secretary of the Treasury and the Secretary of Education expressed strong opposition to the education IRA provisions in this bill, and indicated that they will recommend that the President veto a bill that contains such provisions. In a letter to Members of the Finance Committee dated February 9, 1998, Secretaries Rubin and Riley argued that the provisions would disproportionately benefit the most affluent families and provide little or no benefit to lower and middle-income families. In addition, they indicated that the provisions "would create significant compliance problems."

Treasury Department analyses conclude that seventy percent of the tax benefits from this provision would go to the top twenty percent of all taxpayers. The staff of the Joint Committee on Taxation assumes that the dollar benefit to taxpayers with children in public schools will be "significantly lower" than that attributable to taxpayers with children in private schools.

We therefore believe that the bill will not result in greater opportunity for middle and lower income families to send children to private schools, as supporters contend. Instead, it will merely provide new tax breaks to families already able to afford private schools for their children. Nor do we believe that expansion of the contribution limit and tax-free withdrawal opportunities for education IRAs will lead to increased savings. In our view, these changes will provide further incentives for taxpayers to shift money to tax-favored accounts, and to spend funds that would otherwise be used for retirement.

Further, we are concerned about the additional complexity these changes would add to the Internal Revenue Code. Taxpayers are just beginning to become aware of the hundreds of changes made

in the 1997 tax bill, including the establishment of the education IRA (effective for 1998) for higher education expenses. At a time when calls for simplifying, and even abolishing, the income tax grow ever louder, enactment of the proposed unjustified changes to the education IRA provisions would add a maze of new rules and unanswered questions with which taxpayers and the IRS would be forced to contend.

Taxpayers and the IRS will have difficulty interpreting the definition of a "qualified education expense." For example, such expenses are defined in the bill to include computers and related software and services in connection with the enrollment or attendance of the beneficiary of an education IRA at a school providing elementary or secondary education. Yet the bill provides no guidance for the IRS to determine whether a computer (or use of the Internet) is used by a child for educational purposes or for entertainment, or by the child's parents for unrelated purposes.

The proposal would also add significant complexity by requiring taxpayers to make sophisticated financial calculations each time a withdrawal from the education savings account is made. For instance, after 2002, withdrawals for elementary and secondary education expenses can be made—but only from contributions made during the period from 1999 to 2002 (and from the earnings on such contributions). The law already includes complicated rules for taxpayers to determine the portion of a withdrawal that represents earnings, and the portion that represents a return of contributions. This bill would create different tax consequences depending on whether a withdrawal relates to contributions from three time periods (1998, 1999–2002, and post-2002), and from earnings on such contributions.

School infrastructure

Prior to the Committee's consideration of this legislation on February 10, Chairman Roth and his staff devoted considerable time to working with Members of the Committee on both sides of the aisle to design measures to address the issue of school infrastructure. We appreciate the Chairman's good faith efforts in this regard.

However, during markup the Committee was unable to agree on how best to proceed. As reported, the one provision in the bill related to school infrastructure—the increase in the small issuer arbitrage rebate exception—is nominal compared to the estimated cost of $112 billion to repair existing schools. Last year, Senators Moseley-Braun and Graham brought the issue of crumbling schools to our attention, and they continue to lead efforts to address this serious problem. During the first session of the 105th Congress, Senate Democrats argued that the most efficient way to address this issue was through direct spending. Unfortunately, our previous proposals, such as block grants to the States, were rejected by the majority, and since then we have sought to provide assistance via the Internal Revenue Code for improvements to school infrastructure. We remain committed to identifying and pursuing solutions to this critical problem, and we were pleased that during the Committee's markup, Chairman Roth pledged to hold hearings on this issue and to continue to work with us toward that objective.

DANIEL PATRICK MOYNIHAN.

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