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REPORT
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AFFORDABLE EDUCATION ACT OF 1999

MAY 26, 1999.—Ordered to be printed

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

REPORT

together with

MINORITY VIEWS

[To accompany S. 1134]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance reported an original bill (S. 1134) to amend the Internal Revenue Code of 1986 to allow tax-free expenditures from education individual retirement accounts for elementary and secondary school expenses, to increase the maximum annual amount of contributions to such accounts, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

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I. LEGISLATIVE BACKGROUND AND SUMMARY

A. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up an original bill (the "Affordable Education Act of 1999") on May 19, 1999, and ordered the bill favorably reported by a roll call vote of 11–5 (12–8 including proxy votes).

B. SUMMARY

Education tax incentives (Title I–III)

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, allows a taxpayer to exclude education IRA distributions from gross income and claim the HOPE or Lifetime Learning credit as they are not used for the same expenses, 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, 1999. However, the provision that increase the annual contribution limit for education IRAs (i.e., to $2,000 per year) applies during the period January 1, 2000, through December 31, 2003, the provision that expands the definition of qualified education expenses to include qualified elementary and secondary education expenses, and the provision permitting an exclusion from income for education IRA distributions even if the HOPE or Lifetime Learning credit is claimed applies to contributions (and earnings thereon) made during the period January 1, 2000, through December 31, 2003.

The bill allows taxpayers to receive certain tax-free distributions from qualified State tuition programs. The bill also permits private institutions to offer prepaid tuition plans, effective for taxable years beginning after December 31, 1999. In addition, during the period January 1, 2000, through December 31, 2003, the provision allows taxpayers to exclude qualified State tuition program distributions from income and claim the HOPE or Lifetime Learning credit as long as they are not used for the same expenses. The provisions generally are effective for distributions made in taxable years beginning after December 31, 1999. The exclusion from gross income is extended to private prepaid tuition plans, effective for taxable years beginning after December 31, 2003.

The bill extends the exclusion from gross income for employer-provided educational assistance through June 30, 2004. In addition, the bill expands the section 127 exclusion to apply to graduate courses effective for education commencing after December 31, 1999, and before June 30, 2004.

The bill eliminates the 60-month limit for purposes of the deduction for interest paid on qualified student loans. The provision is effective for interest paid after December 31, 1999.

The bill provides an exclusion from gross income for awards under the National Health Service Corps Scholarship program and the F. Edward Hebert Armed Forces Health Professions Scholarship program, effective for taxable years beginning after December 31, 1993.

The bill increases the arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million, effective for bonds issued after December 31, 1999.

The bill permits the issuance of tax-exempt private activity bonds for qualified education facilities with an annual volume cap of the greater of $10 per resident or $5 million, effective for bonds issued after December 31, 1999.

The bill allows the Federal Home Loan Bank to guarantee up to $500 million annually for school construction bonds, effective for bonds issued after December 31, 1999.

Revenue offsets (Title IV)

The bill provides for the following revenue offsets to pay for the education-related provisions:

Reduce the carryback period for excess foreign tax credits from two years to one year, and extend the carryforward period for excess foreign tax credits from five years to seven years, ef-

fective for foreign tax credits arising in taxable years beginning after December 31, 2001;

Limit the use of the non-accrual experience method of accounting to amounts to be received for the performance of qualified professional services, effective for taxable years ending after the date of enactment;

Provide for information reporting on cancellation of indebtedness by non-bank financial institutions, effective for cancellation of indebtedness after December 31, 1999;

Extend IRS use fees through September 30, 2009;

Clarify the meaning of "subject to" liabilities under section 357(c), effective for transfers on or after October 19, 1998;

Deny a charitable contribution deduction for charitable split dollar insurance, effective for transfers made after February 8, 1999, and for premiums paid after the date of enactment;

Extend through September 30, 2009, the present-law provision allowing employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees;

Impose limitations on the prefunding of certain employee benefits, effective for contributions paid after the date of enactment;

Repeal the installment method for most accrual basis taxpayers and modify the pledge rule applicable to certain other installment sales, effective for sales and other dispositions entered into on or after the date of enactment; and

Include the Streptococcus Pneumonia vaccine as a taxable vaccine in the Federal vaccine insurance program, effective for vaccine purchases the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated Streptococcus Pneumonia vaccines to children.

II. EXPLANATION OF THE BILL

TITLE I—EDUCATION SAVINGS INCENTIVES (SECS. 101–102)

1. Modifications to education individual retirement accounts (sec. 101 of the bill and secs. 530 and 4973 of the Code)

Present law

In general

Section 530 provides tax-exempt status to education individual retirement accounts ("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

[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.

reaches age 18.[2] Moreover, an excise tax is imposed 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.

Phase-out of contribution limit

The $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified adjusted gross income ("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 individual.

Treatment of distributions

Amounts distributed from an education IRA 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 with respect to the beneficiary for the same taxable year). Distributions from an education IRA are generally 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. 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 are 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 are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings are excludable (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 is includable in the distributee's gross income.

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, unless such distribution is made on account of the death or disability of, or scholarship received by, the designated beneficiary. The additional 10-percent tax also does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was

[2] An excise tax may be imposed under present law to the extent that excess contributions above the $500 annual limit are made to an education IRA.

made (for, 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.)

Present law allows tax-free transfers or rollovers 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. 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 and any spouse of such persons or of the original beneficiary.

Any balance remaining in an education IRA is 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).

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 if 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" includes certain room and board expenses 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, 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.[3]

Present law also provides that, if any qualified higher education expenses are taken into account in determining the amount of the exclusion for a distribution from an education IRA, then no deduction (e.g., for trade or business expenses deductible under sec. 162), or exclusion (e.g., for expenses paid with interest on education savings bonds excludable under sec. 135), or credit is allowed with respect to such expenses.

[3] No reduction of qualified higher education expenses is required, however, for a gift, bequest, devise, or inheritance.

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 and contribution limits 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 (e.g., accounts established for the benefit of special needs students). The Committee further believes that the benefits of education IRAs should be coordinated with other education tax provisions so as to maximize the potential benefit of all the education tax incentives.

Explanation of provisions

Annual contribution limit

For the period 2000 through 2003, the bill increases to $2,000 the annual education IRA contribution limit. Thus, under the bill, aggregate contributions that can be made by all contributions to one (or more) education IRAs established on behalf of any particular beneficiary are limited to $2,000 for each year during the period 2000 through 2003. For 2004 and later years, the annual contribution limit for education IRAs will be $500.

Qualified expenses

With respect to contributions made during the period 2000 through 2003 (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,[4] 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 in connection with such enrollment or attendance of the designated beneficiary.

[4] For this purpose, the Committee intends that "academic tutoring" means additional, personalized instruction provided in coordination with the student's academic courses.

"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 2004 or later years (and for earnings attributable to such contributions), the definition of qualified education expenses will be limited to post-secondary education expenses as defined under present law.

The aggregate tax-free distributions from an education IRA for all taxable years for qualified elementary and secondary education expenses cannot exceed the contributions (and earnings thereon) that are made to the education IRA during the period 2000–2003. Distributions in any year in excess of qualified elementary and secondary education expenses will be allocated first to contributions (and earnings thereon) made other than during the period 2000–2003. The bill requires that trustees of education IRAs keep separate accounts with respect to contributions made during the period 2000–2003 and earnings thereon.

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 occur when the beneficiary reaches age 30.[5]

Contributions by persons other than individuals

The bill clarifies that corporations and other entities (including tax-exempt organizations) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution.[6] 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).

Contributions permitted until April 15

Under the bill, individual contributors to education IRAs are deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions), generally April 15. The bill also provides that the additional 10-percent tax does not apply to the distribution of any excess con-

[5] The Committee intends that the determination of whether a beneficiary has "special needs" will 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.

[6] The Committee intends that present-law rules governing the definition of gross income apply for purposes of determining whether a contribution by a corporation or another entity to an education IRA on behalf of a designated beneficiary is includible in the gross income of the beneficiary or another individual (e.g., includible in gross income as compensation to a parent employed by the contributing corporation).

tribution to an education IRA made during the taxable year if such distribution is made on or before the first day of the sixth month of the taxable year (generally June 1) following the taxable year during which the contribution was or was deemed made.[7]

Coordination with HOPE and Lifetime Learning credits

For distributions made during the period January 1, 2000, through December 31, 2003, the bill allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.[8] After 2003, if a HOPE of Lifetime Learning credit is claimed with respect to a student for a taxable year, then a distribution from an education IRA may (at the option of the taxpayer) be made on behalf of that student during that taxable year, but an exclusion from gross income would not be available for the earnings portion of such distribution.

Coordination with qualified tuition programs

The bill repeals the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary (sec. 4973(e)(1)(B)).

Effective date

The provisions modifying education IRAs generally are effective for taxable years beginning after December 31, 1999. The provision increasing the annual contribution limit for education IRAs to $2,000 per year applies during the period January 1, 2000 through December 31, 2003, and the provisions expanding the definition of qualified education expenses to include qualified elementary and

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[7] Thus, taxpayers will now have approximately one and one-half months after the April 15 deadline for making contributions to an education IRA on account of the preceding year to determine whether an excess contribution was made to an education IRA and distribute (or reallocate to the current taxable year) the excess in order to avoid the additional 10-percent tax.

[8] The bill contains no rule for determining the order in which education provisions (e.g., HOPE and Lifetime Learning credits, education IRAs, and qualified tuition plans) must be used during the period 2000–2003. Nevertheless, in most cases, the taxpayer will obtain the greatest tax advantage by claiming either the HOPE or Lifetime Learning credit first and then determining which other education tax incentives are available to him or her. Taxpayers may determine how to allocate their qualified education expenses among the various education provisions for which they are eligible; however, under no circumstances, can the same expenses be allocated to more than one provision. For example, suppose that in 2000, a college freshman withdraws funds from both an education IRA and a qualified tuition program. If the student is otherwise eligible, he or she may claim a HOPE credit of $1,500 with respect to $2,000 of tuition expense. To the extent that the student's remaining educational expenses constitute "qualified higher education expenses" and exceed the amounts distributed from both the education IRA and the qualified tuition program, the student may exclude from gross income the earnings portions (and, as always, the principal portions) of both distributions. Alternatively, if after allocating the first $2,000 of tuition expense to the HOPE credit, the student's remaining educational expenses do not exceed his or her total distributions from the education IRA and qualified tuition program, the student will not be able to exclude from gross income the entire earnings portions of both distributions. In addition, the student may be liable for a penalty imposed under the qualified tuition program or for additional tax imposed on the excess amounts distributed from the education IRA, or both. The student may allocate his or her educational expenses between the distributions as the student determines appropriate, but may not use the same expenses for both distributions, nor may he or she "reuse" the expenses taken into account for purposes of computing the HOPE credit claimed.

secondary expenses applies to contributions (and earnings thereon) made during the period January 1, 2000, through December 31, 2003. The provision coordinating distributions from education IRAs with the HOPE and Lifetime Learning credits is effective for distributions made during the period January 1, 2000, through December 31, 2003.

2. Private pre-paid tuition programs; exclusion from gross income of education distributions from qualified 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 expense of the designated beneficiary of the account (a "savings account plan"). The term "qualified higher education expenses" generally has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expense for tuition, fees, books, supplies,and equipment required for the enrollment or attendance at an eligible educational institution,[9] as well as certain room and board expenses for any period during which the student is at least a half-time student.

No amount is 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) are 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 distributed to a contributor (e.g., when a parent receives a refund) are included in the contributor's gross income to the extent such amounts exceed contributions and on behalf of the beneficiary.[10]

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.[11] 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

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

[10] 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.

[11] 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.

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 is considered a distribution (as is a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family. 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—and any spouse of such persons or of the original beneficiary. 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 of 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.

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) may claim the HOPE credit or Lifetime Learning credit under section 25A with respect to such 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 tuition programs should not be subject to Federal income ax to the extent that such distributions are used to pay for qualified higher education expenses of undergraduate or graduate students who are attending college, university, or certain vocational schools. In addition, the Committee believes that the present-law rules governing qualified tuition programs should be expanded to permit private educational institutions to maintain certain prepaid tuition programs.

Explanation of provisions

Qualified tuition program

The bill expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private educational institutions, persons will be able to purchase tui-

tion credits or certificates on behalf of a designated beneficiary (as set forth in sec. 529(b)(1)(A)(i)), but would not be able to make contributions to a savings account plan (as described in section 529(b)(1)(A)(ii)).

Exclusion from gross income

Under the bill, an exclusion from gross income is provided for distributions made in taxable years beginning after December 31, 1999, from qualified State tuition programs to the extent that the distribution is used to pay for qualified higher education expenses. This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a State or agency or instrumentality thereof, for distributions made in taxable years after December 31, 2003.

For the distributions made during the period, January 1, 2000, through December 31, 2003, the bill allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed.[12] After 2003, if a HOPE or Lifetime Learning credit is claimed with respect to a student for a taxable year, then a distribution from a qualified tuition program may be made on behalf of that student during that taxable year, but an exclusion from gross income would not be available for the earnings portion of such distribution.

Rollovers for benefit of same beneficiary.

The bill provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary will not be considered a distribution for a maximum of three such transfers.

Member of family

The bill further provides that, for purposes of tax-free rollovers and changes of designated beneficiaries, a “member of the family” includes first cousins of the original beneficiary.

Effective date

The provision permitting the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 1999. The exclusion from gross income for certain distributions from qualified State tuition programs under section 529 is effective for distributions made in taxable years beginning after December 31, 1999. In the case of a qualified tuition program established and maintained by an entity other than a State or agency or instrumentality thereof, the provision allowing an exclusion from gross income for certain distributions is effective for distributions made

[12] Examples of how a taxpayer may claim a HOPE or Lifetime Learning credit and, in the same year, exclude from gross income distributions from a qualified tuition program and an education IRA are discussed in connection with the modification of the rules governing education IRAs, supra.

in taxable years beginning after December 31, 2003. The provision coordinating distributions from qualified tuition programs with the HOPE and Lifetime Learning credits is effective for distributions made during the period January 1, 2000, through December 31, 2003.

TITLE II—EDUCATIONAL ASSISTANCE (SECS. 201–203)

1. Exclusion for employer-provided educational assistance (sec. 201 of the bill and sec. 127 of the Code)

Present law

Educational expenses paid by an employer for its employees are generally deductible by the employer.

Employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under a section 127 educational assistance plan or if the expenses qualify as a working condition fringe benefit under section 132. Section 127 provides an exclusion of $5,250 annually for employer-provided educational assistance. The exclusion does not apply to graduate courses. The exclusion for employer-provided educational assistance expires with respect to courses beginning on or after June 1, 2000.

In order for the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The educational assistance program must not discriminate in favor of highly compensated employees. In addition, not more than 5 percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance plan can be provided for the class of individuals consisting of more than 5-percent owners of the employer (and their spouses and dependents).

Educational expenses that do not qualify for the section 127 exclusion may be excludable from income as a working condition fringe benefit.[13] In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if 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, applicable law or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business.[14]

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 addi-

[13] These rules also apply in the event that section 127 expires and is not reinstated.

[14] In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized education only if such expenses, along with other miscellaneous deductions, exceed 2 percent of the taxpayer's AGI. The 2-percent floor limitation is disregarded in determining whether an item is excludable as a working condition fringe benefit.

tional 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 worker's 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 provision extends the present-law exclusion for employer-provided educational assistance to undergraduate courses beginning before July 1, 2004. The provision also extends the exclusion to graduate education, effective for courses beginning after January 1, 2000, and before July 1, 2004.

Effective date

The provision extends the exclusion for undergraduate courses would be effective for courses beginning before July 1, 2004. The exclusion with respect to graduate-level courses is effective for courses beginning after January 1, 2000, and before July 1, 2004.

2. Eliminate 60-month limit on student loan interest deduction (sec. 202 of the bill and sec. 221 of the Code)

Present law

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter[15]. The deduction is phased out ratably for individual taxpayers with modified adjusted gross income of $40,000–$55,000 and $60,000–$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

Reasons for change

The Committee believes that it is appropriate to expand the deduction for individuals who have paid interest on qualified education loans by repealing the limitation that the deduction is allowed only with respect to interest paid during the first 60 months in which interest payment are required. In addition, the repeal of the 60-month limitation lessens complexity and administrative burdens for taxpayers, lenders, loan servicing agencies, and the Internal Revenue Service.

Explanation of provision

The bill repeals both the limit on the number of months during which interest paid on a qualified education loan is deductible and the restriction that nonmandatory payments of interest are not deductible.

Effective date

The provision is effective for interest paid on qualified education loans after December 31, 1999.

3. Eliminate tax on awards under National Health Service Corps Scholarship Program and F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (sec. 203 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 course 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 scholarships, section 117 provides an exclusion from gross

[15] The maximum allowable deduction for 1998 was $1,000.

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.

The National Health Service Corps Scholarship Program (the "NHSC Scholarship Program") and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program") provide education awards to participant on condition that the participants provide certain services. In the case of the NHSC Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an undeserved population group or designated facility) identified by the Public Health Service as having a shortage of health-care professionals. In the case of the Armed Forces Scholarship Program the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility. Because the recipients are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

Reasons for change

The Committee believes that it is appropriate to provide tax-free treatment for scholarships received by medical, dental, nursing, and physician assistant students under the NHSC Scholarship Program and Armed Forces Scholarship Program.

Explanation of provision

The bill provides that amounts received by an individual under the NHSC Scholarship Program or the Armed Forces Scholarship Program are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students for regular living expenses, including room and board.

Effective date

The provision is effective for education awards received after December 31, 1993.

TITLE III—LIBERALIZATION OF TAX-EXEMPT FINANCING RULES FOR PUBLIC SCHOOL CONSTRUCTION (SECS. 301–303 OF THE BILL AND SECS. 103 AND 148 OF THE CODE)

Present law

1. Tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to

carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103). Like other activities carried out and paid for by States and local governments, the construction, renovation, and operation of public schools is an activity eligible for financing with the proceeds of tax-exempt bonds.

Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds." The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

The Code includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code—including elementary, secondary, and post-secondary schools—may be financed with tax-exempt private activity bonds ("qualified 501(c)(3) bonds").

States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Businesses eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated low-income rental housing; and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities." Tax-exempt financing is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses.

Finally, tax-exempt private activity bonds may be issued to finance limited non-business purposes: student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds").

In most cases, the volume of tax-exempt private activity bonds is restricted by aggregate annual limits imposed on bonds issued by issuers within each State. These annual volume limits equal $50 per resident of the State, or $150 million if greater. The annual State private activity bond volume limits are scheduled to increase to the greater of $75 per resident of the State or $225 million in calendar year 2007. The increase will be phased in ratably beginning in calendar year 2003. This increase was enacted by the Tax and Trade Relief Extension Act of 1998. Qualified 501(c)(3) bonds

are among the tax-exempt private activity bonds that are not subject to these volume limits.

Private activity tax-exempt bonds may not be used to finance schools owned or operated by private, for-profit businesses.

Arbitrage restrictions on tax-exempt bonds

The Federal income tax does not apply to income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than necessary, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

The Code includes three exceptions applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance. In the case of governmental bonds (including bonds to finance public schools) the six-month expenditure exception is treated as satisfied if at least 95 percent of the proceeds is spent within six months and the remaining five percent is spent within 12 months after the bonds are issued.

Second, in the case of bonds to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months for construction proceeds. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24-month period and prescribed intermediate spending percentages are satisfied.

Third, governmental bonds issued by "small" governments are not subject to the rebate requirement. Small governments are defined as general purpose governmental units that issue no more than $5 million of tax-exempt governmental bonds in a calendar year. The $5 million limit is increased to $10 million if at least $5 million of the bonds are used to finance public schools.

Restriction on Federal guarantees of tax-exempt bonds

Unlike interest on State or local government bonds, interest on Federal debt (e.g., Treasury bills) is taxable. Generally, interest on State and local government bonds that are Federally guaranteed does not qualify for tax-exemption. This restriction was enacted in 1984. The 1984 legislation included exceptions for housing bonds and for certain other Federal insurance programs that were in existence when the restriction was enacted.

2. Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, certain States and local governments are given the authority to issue "qualified zone academy bonds." Under present law, a total of $400 million of qualified zone academy bonds may be issued in each of 1998 and 1999. The $400 million aggregate bond authority is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit to qualified zone academies within such State. A State may carry over any unused allocation into subsequent years.

Certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate (set monthly by Treasury Department regulation at 110 percent of the applicable Federal rate for the month in which the bond is issued) multiplied by the face amount of the bond (sec. 1397E). The credit rate applies to all such bonds issued in each month. A taxpayer holding a qualified zone academy bond on the credit allowance date (i.e., each one-year anniversary of the issuance of the bond) is entitled to a credit. The credit amount is includable in gross income (as if it were a taxable interest payment on the bond), and credit may be claimed against regular income tax and alternative minimum tax liability.

"Qualified zone academy bonds" are defined as bonds issued by a State or local government, provided that: (1) at least 95 percent of the proceeds is used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy;" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or a designated enterprise community, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Reasons for change

The policy underlying the arbitrage rebate exception for bonds of small governmental units is to reduce complexity for these entities because they may not have in-house financial staff to engage in the expenditure and investment tracking necessary for rebate compliance. The exception further is justified by the limited potential for arbitrage profits at small issuance levels and limitation of the provisions to governmental bonds, which typically require voter approval before issuance. The Committee believes that a limited increase of $5 million per year for public school construction bonds

will more accurately conform this present-law exception to current school construction costs.

Further, the Committee wishes to encourage public-private partnerships to improve educational opportunities. To permit public-private partnerships to reap the benefit of the implicit subsidy to capital costs provided through tax-exempt financing, the Committee determined that is appropriate to allow the issuance of tax-exempt private activity bonds for public school facilities.

Finally, the Committee believes it is appropriate to foster public school construction by permitting the Federal Home Loan Bank Board to satisfy its present-law community development requirements in a more cost-effective manner—by guaranteeing tax-exempt bonds for such construction.

Explanation of provisions

1. Increase amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirement is increased from $5 million to $10 million. Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year provided that at least $10 million of the bonds are used to finance public school construction expenditures.

2. Allow issuance of tax-exempt private activity bonds for public school facilities

The private activities for which tax-exempt bonds may be issued are expanded to include elementary and secondary public school facilities which are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events) [16] and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes or equips a school facility. The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State volume limit equal to the greater of $10 per resident ($5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States decide how to allocate the bond authority to State and local governments agencies. Bond authority that is unused in the year in which it arises may be carried forward for up

[16] The present-law limit on the amount of the proceeds of a private activity bond issue that may be used to finance land acquisition does not apply to these bonds.

to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

3. Permit limited Federal guarantees of school construction bonds by the Federal Housing Finance Board

The Federal Housing Finance Board is permitted to guarantee (through the regional Federal Home Loan Banks in its system) up to $500 million per year of governmental bonds 95 percent of more of the proceeds of which are used for public schools construction (including renovation).

Effective dates

These provisions of the bill are effective for bonds issued after December 31, 1999.

TITLE IV—REVENUE PROVISIONS (SECS. 401–410)

1. Modify foreign tax credit carryover rules (sec. 401 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 to seven years.

Effective date

The provision applies to foreign tax credits arising in taxable years beginning after December 31, 2001.

2. Limit use of non-accrual experience method of accounting to amounts to be received for the performance of a qualified personal services (sec. 402 of the bill and sec. 448 of the Code)

Present law

An accrual method taxpayer generally must recognize income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. An accrual method taxpayer may deduct the amount of any receivable that was previously included in income that becomes worthless during the year.

Accrual method taxpayers are not required to include in income amounts to be received for the performance of services which, on the basis of experience, will not be collected (the "non-accrual experience method"). The availability of this method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount charged.

A cash method taxpayer is not required to include an amount in income until it is received. A taxpayer may not use the cash method if the purchase, production, or sale of merchandise is a material income producing factor. Such taxpayers are generally required to keep inventories and use the accrual method of accounting. In addition, corporations (and partnerships with corporate partners) generally may not use the cash method of accounting if their average annual gross receipts exceed $5 million. An exception to this $5 million rule is provided for qualified personal service corporations, which are corporations (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or their heirs. Qualified personal service corporations may use the cash method without regard to whether their average annual gross receipts exceed $5 million.

Reasons for change

The Committee understands that the use of the non-accrual experience method provides the equivalent of a bad debt reserve, which generally is not available to taxpayers using the accrual method of accounting. The Committee believes that accrual method taxpayers should be treated similarly, unless there is a strong indication that different treatment is necessary to clearly reflect income or to address a particular competitive situation.

The Committee understands that accrual basis providers of qualified personal services (services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting) compete on a regular basis and on an even footing with competitors using the cash method of accounting. The Committee believes that this competitive situation justifies the continued availability of the non-accrual experience method with respect to amounts to be received for the performance of qualified personal services. The Committee believes that it is important to avoid the disparity of treatment between competing cash and accrual method providers of qualified personal services that could re-

sult if the non-accrual experience method were eliminated with regard to amounts to be received for such services.

Explanation of provision

The bill provides that the non-accrual experience method will be available only for amounts to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services will be subject to the general rule regarding inclusion in income. Qualified personal services are personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. As under present law, the availability of the method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount.

Effective date

The provision is effective for taxable years ending after the date of enactment. Any change in the taxpayer's method of accounting necessitated as a result of the proposal will be treated as a voluntary change initiated by the taxpayer with the consent of the Secretary of the Treasury. Any required section 481(a) adjustment is to be taken into account over a period not to exceed four years under principles consistent with those in Rev. Proc. 98–60.[17]

3. Expand reporting of cancellation of indebtedness income (sec. 403 of the bill and sec. 6050P of the Code)

Present law

Under section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. Section 6050P requires "applicable entities" to file information returns with the Internal Revenue Service (IRS) regarding any discharge of indebtedness of $66 or more.

The information return must set forth the name, address, and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, the date on which the debt was discharged, and any other information that the IRS requires to be provided. The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

"Applicable entities" include: (1) the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC), the National Credit Union Administration, and any successor or subunit of any of them; (2) any financial institution (as described in sec. 581 (relating to banks) or sec. 591(a) (relating to savings institutions)); (3) any credit union; (4) any corporation that is a direct or indirect subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; and (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. sec. 3701(a)(4)).

[17] 1998–51 I.R.B. 16.

Failures to file correct information returns with the IRS or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

Reasons for change

The Committee believes that it is appropriate to treat discharges of indebtedness that are made by similar entities in a similar manner. Accordingly, the Committee believes that it is appropriate to extend the scope of this information reporting provision to include indebtedness discharged by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

Explanation of provision

The bill requires information reporting on indebtedness discharged by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

Effective date

The provision is effective with respect to discharges of indebtedness after December 31, 1999.

4. Extension of IRS user fees (sec. 404 of the bill and new sec. 7527 of the Code)

Present law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104–117 [18] extended the statutory authorization for these user fees [19] through September 30, 2003.

Reasons for change

The Committee believes that it is appropriate to extend the statutory authorization for these user fees for an additional six years.

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[18] An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[19] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Public Law 100–203, December 22, 1987).

Explanation of provision

The bill extends the statutory authorization for these user fees through September 30, 2009. The bill also moves the statutory authorization for these fees into the Internal Revenue Code.

Effective date

The provision, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

5. Clarify definition of "subject to" liabilities under Code section 357(c) (sec. 405 of the bill and secs. 357 and 362 of the Code)

Present law

Present law provides that the transferor of property recognizes no gain or loss if the property is exchanged solely for qualified stock in a controlled corporation (sec. 351). The assumption by the controlled corporation of a liability of the transferor (or the acquisition of property "subject to" a liability) generally will not cause the transferor to recognize gain. However, under section 357(c), the transferor does recognize gain to the extent that the sum of the assumed liabilities, together with the liabilities to which the transferred property is subject, exceeds the transferor's basis in the transferred property. If the transferred property is "subject to" a liability, Treasury regulations indicate that the amount of the liability is included in the calculation regardless of whether the underlying liability is assumed by the controlled corporation. Treas. Reg. sec. 1.357–2(a). Similar rules apply to reorganizations described in section 368(a)(1)(D).

The gain recognition rule of section 357(c) is applied separately to each transferor in a section 351 exchange.

The basis of the property in the hands of the controlled corporation equals the transferor's basis in such property, increased by the amount of gain recognized by the transferor, including section 357(c) gain.

Reasons for change

The tax treatment under present law is unclear in situations involving the transfer of certain liabilities. As a result, the Committee is concerned that some taxpayers may be structuring transactions to take advantage of the uncertainty. For example, where more than one asset secures a single liability, some taxpayers might take the position that, on a transfer of the assets to different subsidiaries, each subsidiary counts the entire liability in determining the basis of the asset. This interpretation arguably might result in the duplication of tax basis or in assets having a tax basis in excess of their value, resulting in excessive depreciation deductions and mismeasurement of income. The provision is intended to eliminate the uncertainty, and to better reflect the underlying economics of these corporate transfers.

Explanation of provision

Under the provision, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability generally is eliminated. First, except as provided in Treasury regulations, a recourse liability (or any portion thereof) is treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed to, and is expected to satisfy the liability or portion thereof (whether or not the transferor has been relieved of the liability). Thus, where more than one person agrees to satisfy a liability or portion thereof, only one would be expected to satisfy such liability or portion thereof. Second, except as provided in Treasury regulations, a nonrecourse liability (or any portion thereof) is treated as having been assumed by the transferee of any asset that is subject to the liability. However, this amount is reduced in cases where an owner of other assets subject to the same nonrecourse liability agrees with the transferee to, and is expected to, satisfy the liability (up to the fair market value of the other assets, determined without regard to section 7701(g)).

In determining whether any person has agreed to and is expected to satisfy a liability, all facts and circumstances are to be considered. In any case where the transferee does agree to satisfy a liability, the transferee also will be expected to satisfy the liability in the absence of facts indicating the contrary.

In determining any increase to the basis of property transferred to the transferee as a result of gain recognized because of the assumption of liabilities under section 357, in no event will the increase cause the basis to exceed the fair market value of the property (determined without regard to sec. 7701(g)).

If gain is recognized to the transferor as the result of an assumption by a corporation of a nonrecourse liability that also is secured by any assets not transferred to the corporation, and if no person is subject to Federal income tax on such gain, then for purposes of determining the basis of assets transferred, the amount of gain treated as recognized as the result of such assumption of liability shall be determined as if the liability assumed by the transferee equaled such transferee's ratable portion of the liability, based on the relative fair market values (determined without regard to sec. 7701(g)) of all assets subject to such nonrecourse liability. In no event will the gain cause the resulting basis to exceed the fair market value of the property (determined without regard to sec. 7701(g)).

The Treasury Department has authority to prescribe such regulations as may be necessary to carry out the purposes of the provision. This authority includes the authority to specify adjustments in the treatment of any subsequent transactions involving the liability, including the treatment of payments actually made with respect to any liability as well as appropriate basis and other adjustments with respect to such payments. Where appropriate, the Treasury Department also may prescribe regulations which provide that the manner in which a liability is treated as assumed under the provision is applied elsewhere in the Code.

Effective date

The provision is effective for transfers on or after October 19, 1998. No inference regarding the tax treatment under present law is intended.

6. Denial of charitable contribution deduction for transfers associated with charitable split-dollar insurance arrangements (sec. 406 of the bill and sec. 170(f)(10) of the Code)

Present law

Under present law, in computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). A charitable contribution is defined to mean a contribution or gift to or for the use of a charitable organization or certain other entities (sec. 170(c)). The term "contribution or gift" is not defined by statute, but generally is interpreted to mean a voluntary transfer of money or other property without receipt of adequate consideration and with donative intent. If a taxpayer receives or expects to receive a quid pro quo in exchange for a transfer to charity, the taxpayer may be able to deduct the excess of the amount transferred over the fair market value of any benefit received in return, provided the excess payment is made with the intention of making a gift.[20]

In general, no charitable contribution deduction is allowed for a transfer to charity of less than the taxpayer's entire interest (i.e., a partial interest) in any property (sec. 170(f)(3)). In addition, no deduction is allowed for any contribution of $250 or more unless the taxpayer obtains a contemporaneous written acknowledgment from the donee organization that includes a description and good faith estimate of the value of any goods or services provided by the donee organization to the taxpayer in consideration, whole or part, for the taxpayer's contribution (sec. 170(f)(8)).

Reasons for change

The Committee is concerned about an abusive scheme[21] referred to as charitable split-dollar life insurance, and the provision is designed to stop the spread of this scheme. Under this scheme, taxpayers typically transfer money to a charity, which the charity then uses to pay premiums for cash value life insurance on the transferor or another person. The beneficiaries under the life insurance contract typically include members of the transferor's family (either directly or through a family trust or a family partnership). Having passed the money through a charity, the transferor claims a charitable contribution deduction for more that is actually being

[20] *United States* v. *American Bar Endowment,* 477 U.S. 105 (1986). Treas. Reg. sec. 1.170A–1(h).

[21] "A Popular Tax Shelter for 'Angry Affluent' Prompts Ire of Others," Wall Street Journal, Jan. 22, 1999, p. A1; "U.S. Treasury Officials Investigating Charitable Split-Dollar Insurance Plan," Wall Street Journal, Jan. 29, 1999, p. B5; "Brilliant Deduction?," The Chronicle of Philanthropy, Aug. 13, 1998, p. 24; "Charitable Reverse Split-Dollar: Bonanza or Booby Trap," Journal of Gift Planning, 2nd quarter 1998.

used to benefit the transferor and his or her family. If the transferor or the transferor's family paid the premium directly, the payment would not be deductible. Although the charity eventually may get some of the benefit under the life insurance contract, it does not have unfettered use of the transferred funds.

The Committee is concerned that this type of transaction represents an abuse of the charitable contribution deduction. The Committee is also concerned that the charity often gets relatively little benefit from this type of scheme, and serves merely as a conduit or accommodation party, which the Commission does not view as appropriate for an organization with tax-exempt status. In substance, the charity receives a transfer of a partial interest in an insurance policy, for which no charitable contribution deduction is allowed. While there is no basis under present law for allowing a charitable contribution deduction in these circumstances, the Committee intends that the provision stop the marketing of these transactions immediately.

Therefore, the provision clarifies present law by specifically denying a charitable contribution deduction for a transfer to a charity if the charity directly or indirectly pays or paid any premium on a life insurance, annuity or endowment contract in connection with the transfer, and any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other noncharitable person chosen by the transferor. In addition, the provision clarifies present law by specifically denying the deduction for a charitable contribution if, in connection with a transfer to the charity, there is an understanding or expectation that any person will directly or indirectly pay any premium on any such contract.

The provision provides that certain persons are not treated as indirect beneficiaries, in certain cases in which a charitable organization purchases an annuity contract to fund an obligation to pay a charitable gift annuity. The provision also provides that a person is not treated as an indirect beneficiary solely by reason of being a noncharitable recipient of an annuity or unitrust amount paid by a charitable remainder trust that holds a life insurance, annuity or endowment contract. The rationale for these rules is that amount of the charitable contribution deduction is limited under present law to the value of the charitable organization's interest. Congress has previously enacted rules designed to prevent a charitable contribution deduction for the value of any personal benefit to the donor in these circumstances, and the Committee expects that the personal benefit to the donor is appropriately valued.

Further, the provision imposes an excise tax on the charity, equal to the amount of the premiums paid by the charity. Finally, the provision requires a charity to report annually to the Internal Revenue Service the amount of premiums subject to this excise tax and information about the beneficiaries under the contract.

Explanation of provision

Deduction denial

The provision[22] restates present law to provide that no charitable contribution deduction is allowed for purposes of Federal tax, for a transfer to or for the use of an organization described in section 170(c) of the Internal Revenue Code, if in connection with the transfer (1) the organization directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or (2) there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. It is intended that an organization be considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.

A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract, if any direct or indirect beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a section 170(c) organization) designated by the transferor. For example, such a beneficiary would include a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's family, and would include an entity that is controlled by the transferor or any member of the transferor's family. It is intended that a beneficiary under the contract include any beneficiary under any side agreement relating to the contract. If a transferor contributes a life insurance contract to a section 170(c) organization and designates one or more section 170(c) organizations as the sole beneficiaries under the contract, generally, it is not intended that the deduction denial rule under the provision apply. If, however, there is an outstanding loan under the contract upon the transfer of the contract, then the transferor is considered as a beneficiary. The fact that a contract also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or designated by the transferor) does not prevent it from being a personal benefit contract. The provision is not intended to affect situations in which an organization pays premiums under a legitimate fringe benefit plan for employees.

It is intended that a person be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract. For this purpose, as described below, an indirect beneficiary is not intended to include a person that benefits exclusively under a bona fide charitable gift annuity (within the meaning of sec. 501(m)).

In the case of a charitable gift annuity, if the charitable organization purchases an annuity contract issued by an insurance company to fund its obligation to pay the charitable gift annuity, a person receiving payments under the charitable gift annuity is not treated as an indirect beneficiary, provided certain requirements are met. The requirements are that (1) the charitable organization

[22] The provision is similar to H.R. 630, introduced by Mr. Archer for himself and for Mr. Rangel (106th Cong., 1st Sess.).

possess all of the incidents of ownership (within the meaning of Treas. Reg. sec. 20.2042–1(c)) under the annuity contract purchased by the charitable organization; (2) the charitable organization be entitled to all the payments under the contract; and (3) the timing and amount of payments under the contract be substantially the same as the timing and amount of payments to each person under the organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

In the case of a charitable gift annuity obligation that is issued under the laws of a State that requires, in order for the charitable gift annuity to be exempt from insurance regulation by that State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in that State, then the foregoing requirements (1) and (2) are treated as if they are met, provided that certain additional requirements are met. The additional requirements are that the State law requirement was in effect on February 8, 1999, each beneficiary under the charitable gift annuity is a bona fide resident of the State at the time the charitable gift annuity was issued, the only persons entitled to payments under the annuity contract issued by the insurance company are persons entitled to payments under the charitable gift annuity when its was issued, and (as required by clause (iii) of subparagraph (D) of the provision) the timing and amount of payments under the annuity contract to each person are substantially the same as the timing and amount of payments to the person under the charitable organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

In the case of a charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)) that holds a life insurance, endowment or annuity contract issued by an insurance company, a person is not treated as an indirect beneficiary under the contract held by the trust, solely by reason of being a recipient of an annuity of an annuity or unitrust amount paid by the trust, provided that the trust possesses all of the incidents of ownership under the contract and is entitled to all the payments under such contract. No inference is intended as to the applicability of other provisions of the Code with respect to the acquisition by the trust of a life insurance, endowment or annuity contract, or the appropriateness of such an investment by a charitable remainder trust.

Nothing in the provision is intended to suggest that a life insurance, endowment, or annuity contract would be a personal benefit contract, solely because an individual who is a recipient of an annuity or unitrust amount paid by a charitable remainder annuity trust or charitable remainder unitrust uses such a payment to purchase a life insurance, endowment or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise tax

The provision imposes on any organization described in section 170(c) of the Code an excise tax, equal to the amount of the pre-

miums paid by the organization on any life insurance, annuity, or endowment contract, if the premiums are paid in connection with a transfer for which a deduction is not allowable under the deduction denial rule of the provision (without regard to when the transfer to the charitable organization was made). The excise tax does not apply if all of the direct and indirect beneficiaries under the contract (including any related side agreement) are organizations described in section 170(c). Under the provision, payments are treated as made by the organization, if they are made by any other person pursuant to an understanding or expectation of payment. The excise tax is to be applied taking into account rules ordinarily applicable to excise taxes in chapter 41 or 42 of the Code (e.g., statute of limitation rules).

Reporting

The provision requires that the charitable organization annually report the amount of premiums that is paid during the year and that is subject to the excise tax imposed under the provision, and the name and taxpayer identification number of each beneficiary under the life insurance, annuity or endowment contract to which the premiums relate, as well as other information required the Secretary of the Treasury. For this purpose, it is intended that a beneficiary include any beneficiary under any side agreement to which the section 170(c) organization is a party (or of which it is otherwise aware). Penalties applicable to returns required under Code section 6033 apply to returns under this reporting requirements. Returns required under this provision are to be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

Regulations

The provision provides for the promulgation of regulations necessary or appropriate to carry out the purposes of the provisions, including regulations to prevent the avoidance of the purposes of the provisions. For example, it is intended that regulations prevent avoidance of the purposes of the provision by inappropriate or improper reliance on the limited exceptions provided for certain beneficiaries under *bona fide* charitable gift annuities and for certain noncharitable recipients of an annuity or unitrust amount paid by a charitable remainder trust.

Effective date

The deduction denial provision applies to transfers after February 8, 1999 (as provided in H.R. 630). The excise tax provision applies to premiums paid after the date of enactment. The reporting provision applies to premiums paid after February 8, 1999 (determined as if the excise tax imposed under the provision applied to premiums paid after that date).

No inference is intended that a charitable contribution deduction is allowed under present law with respect to a charitable split-dollar insurance arrangement. The provision does not change the rules with respect to fraud or criminal or civil penalties under present law; thus, actions constituting fraud or that are subject to

penalties under present law would still constitute fraud or be subject to the penalties after enactment of the provision.

7. Treatment of excess pension assets used for retiree health benefits (sec. 407 of the bill and sec. 420 of the Code)

Present law

Defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. A reversion prior to plan termination may constitute a prohibited transaction and my result in disqualification of the plan. Certain limitations and procedural requirements apply to a reversion upon plan termination. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate, which my be as high as 50 percent of the reversion, varies depending upon whether or not the employer maintains a replacement plan or makes certain benefit increases. Upon plan termination, the accrued benefits of all plan participants are required to be 100-percent vested.

A pension plan may provide medical benefits to retired employees through a section 401(h) account that is a part of such plan. A qualified transfer of excess assets of a defined benefit pension plan (other than a multiemployer plan) into a section 401(h) account that is a part of such plan does not result in plan disqualification and is not treated as a reversion to the employer or a prohibited transaction. Therefore, the transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions.

Qualified transfers are subject to amount and frequency limitations, use requirements, deduction limitations, vesting requirements and minimum benefit requirements. Excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No more than one qualified transfer with respect to any plan may occur in any taxable year.

The transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. Transferred amounts generally must benefit all pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the section 401(h) account. Retiree health benefits of key employees may not be paid (directly or indirectly) out of transferred assets. Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

No deduction is allowed for (1) a qualified transfer of excess pension assets into a section 401(h) account, (2) the payment of qualified current retiree health liabilities out of transferred assets (and any income thereon) or (3) a return of amounts not used to pay

qualified current retiree health liabilities to the general assets of the pension plan.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer.

The minimum benefit requirement requires each group health plan under which applicable health benefits are provided to provide substantially the same level of applicable health benefits for the taxable year of the transfer and the following 4 taxable years. The level of benefits that must be maintained is based on benefits provided in the year immediately preceding the taxable year of the transfer. Applicable health benefits are health benefits or coverage that are provided to (1) retirees who, immediately before the transfer, are entitled to receive such benefits upon retirement and who are entitle to pension benefits under the plan and (2) the spouses and dependents of such retirees.

The provision permitting a qualified transfer of excess pension assets to pay qualified current retiree health liabilities expires for taxable years beginning after December 31, 2000.[23]

Reasons for change

The Committee believes that it is appropriate to provide a temporary extension of the present-law rule permitting an employer to make a qualified transfer of excess pension assets to a section 401(h) account for retiree health benefits as long as the security of employees' pension benefits is not threatened by the transfer. In light of the increasing cost of retiree health benefits, the Committee also believes that it is appropriate to replace the minimum benefit requirement applicable to qualified transfers under present law with a minimum cost requirement.

Explanation of provision

The present-law provision permitting qualified transfers of excess defined benefit pension plan assets to provide retiree health benefits under a section 401(h) account is extended through September 30, 2009[24]. In addition, the present-law minimum benefit requirement is replaced by the minimum cost requirement that applied to qualified transfers before December 9, 1994, to section 401(h) accounts. Therefore, each group health plan of arrangement under which applicable health benefits are provided is required to provide a minimum dollar level of retiree health expenditures for the taxable year of the taxable year of the transfer and the following 4 taxable years. The minimum dollar level is the higher of the applicable employer costs for each of the 2 taxable years immediately

[23] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), provides that plan participants, the Secretaries of Treasury and the Department of Labor, the plan administrator, and each employee organization representing plan participant must be notified 60 days before a qualified transfer of excess assets to a retiree health benefits account occurs (ERISA sec. 103(e). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA (ERISA sec. 408(b)(13) or a prohibited reversion of assets to the employer (ERISA sec. 403(c)(1)). For purposes of these provisions, a qualified transfer is generally defined as a transfer pursuant to section 420 of the Internal Revenue Code, as in effect on January 1, 1995.

[24] In addition to amendments to the Internal Revenue Code, the provision makes conforming amendments to the applicable sections of the ERISA. That is, the provision provides that, for purposes of the applicable sections of ERISA, a qualified transfer is defined as under section 420 of the Internal Revenue Code, as in effect on January 1, 2000.

preceding the taxable year of the transfer. The applicable employer cost for a taxable year is determined by dividing the employer's qualified current retiree health liabilities by the number of individuals to whom coverage for applicable health benefits was provided during the taxable year.

Effective date

The provision is effective with respect to qualified transfers of excess defined benefit pension plan assets to section 401(h) accounts after December 31, 2000, and before October 1, 2009.

The minimum benefit requirement continues to apply to qualified transfers before the effective date, and the minimum cost requirement applies to transfers after the effective date. For example, suppose an employer (with a calendar year taxable year) made a qualified transfer in 1998. The minimum benefit requirement must be satisified for calendar years 1998, 1999, 2000, 2001, and 2002. Suppose the employer also makes a qualified transfer in 2001. Then, both the minimum cost and benefit requirement must be satisfied in 2001 and 2002, and the minimum cost requirement must be satisfied in 2003, 2004, and 2005.

8. Impose limitation on prefunding of certain employee benefits (sec. 408 of the bill and secs. 419A and 4976 of the Code)

Present law

Under present law, contributions to a welfare benefit fund generally are deductible when paid, but only to the extent permitted under the rules of Code sections 419 and 419A. The amount of an employer's deducation in any year for contributions to a welfare benefit fund cannot exceed the fund's qualified cost for the year. The term qualified cost means the sum of (1) the amount that would be deductible for benefits provided during the year if the employer paid them directly and was on the cash method of accounting, and (2) within limits, the amount of any addition to a qualified asset account for the year. A qualified asset account includes any account consisting of assets set aside for the payment of disability benefits, medical benefits, supplemental unemployment compensation or serverance pay benefits, of life insurance benefits.

The account limit for a qualified asset account for a taxable year is generally the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for benefits with respect to which the account is maintained and the administrative costs incurred with respect to those claims. Specific additional reserves are allowed for future provision of post-retirement medical and life insurance benefits.

The present-law deduction limits for contributions to welfare benefit funds do not apply in the case of certain 10-or-more employer plans. A plan is a 10-or-more employer plan if (1) more than one employer contributes to it, (2) no employer is normally required to contribute more than 10 percent of the total contributions under the plan by all employees, and (3) the plan does not maintain experience-rating arrangements with respect to individual employers.

If any portion of a welfare benefit fund reverts to the benefit of an employer that maintains the fund, an excise tax equal to 100 percent of the reversion is imposed on the exployer.

Reasons for change

The Committee understands that the exception to the welfare benefit fund deduction limits for 10-or-more employer plans has been utilized to fund retirement-type benefits and avoid the dollar limitations and other rules applicable to qualified retirement plans and the deduction timing rules applicable to nonqualified deferred compensation arrangements. Congress intended the exception to apply to a multiple employer welfare benefit plan under which the relationship of a participating employer to the plan is similar to the relationship of an insured to an insurer, and did not intend the exception to apply if the liability of any employer under the plan is determined on the basis of experience rating, which can create, in effect, a single-employer plan within a 10-or-more-employment arrangement. It is difficult to identify whether experience rating is occurring with respect to the provision of some benefits, such as severance pay and certain death benefits, because of the complexity of the benefit arrangments. Therefore, the Committee believes that it is appropriate to limit the benefits for which the 10-or-more employer exception is available.

Explanation of provision

Under the provision, the present-law exception to the deduction limit for 10-or-more employer plans is limited to plans that provide only medical benefits, disability benefits and group-term life insurance benefits which do not provide for any cash surrender value or other money that can be paid, assigned, borrowed or pledged for collateral of a loan. This exception is no longer available with respect to plans that provide supplemental unemployment compensation, severance pay and life insurance (other than group-term life) benefits. Thus, the generally applicable deducation limits (sections 419 and 419A) apply to plans providing these benefits.

In addition, if any portion of a welfare benefit fund attributable to contributions that are deductible pursuant to the 10-or-more employer exception (and earnings thereon) is used for a purpose other than that for which the contributions were made (including cash payments to employees upon termination of the fund), such portion is treated as reverting to the benefit of the employers maintaining the fund and is subject to the imposition of the 100-percent excise tax.

Under the provision, no inference is intended with respect to the validity of any 10-or-more employer arrangement under the provisions of present law.

Effective date

The provision is effective with respect to contributions paid after the date of enactment.

9. Modify installment method and prohibit its use by accrual method taxpayers (sec. 409 of the bill and secs. 453 and 453A of the Code)

Present law

An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. The installment method of accounting provides an exception to this general principle of income recognition by allowing a taxpayer to defer the recognition of income from the disposition of certain property until payment is received. Sales to customers in the ordinary course of business are not eligible for the installment methods, except for sales of property used or produced in the trade or business of farming and sales of timeshares and residential lots if an election to pay interest under section 453(l)(2)(B) is made.

A pledge rule provides that if an installment obligation is pledged as security for any indebtedness, the net proceeds [25] of such indebtedness are treated as a payment on the obligation, triggering the recognition of income. Actual payments received on the installment obligation subsequent to the receipt of the loan proceeds are not taken into account until such subsequent payments exceed the loan proceeds that were treated as payments. The pledge rule does not apply to sales of property used or produced in the trade or business of farming, to sales of timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), or to dispositions where the sales price does not exceed $150,000.

An additional rule requires the payment of interest on the deferred tax that is attributable to most large installment sales.

Reasons for change

The Committee believes that the installment method is inconsistent with the use of the accrual method of accounting and should not be allowed in situations where the disposition of property would otherwise be reported using the accrual method. The Committee is concerned that the continued use of the installment in such situations would allow a deferral of gain that is inconsistent with the requirement of the accrual method that income be reported in the period it is earned, rather than the period it is received.

The Committee also believes that the installment method, where its use is appropriate, should not serve to defer the recognition of gain beyond the time when funds are received. Accordingly, the Committee believes that proceeds of a loan should be treated in the same manner as a payment on an installment obligation if the loan is dependent on the existence of the installment obligation, such as where the loan is secured by the installment obligation or can be satisfied by the delivery of the installment obligation.

[25] The net proceeds equal the gross loan proceeds less the direct expenses of obtaining the loan.

The Committee recognizes that special considerations exist in the disposition of property that is used or produced in the trade or business of farming, as well as certain dispositions of timeshares and residential lots where an election is made to pay interest on deferred taxes. The Committee does not believe that the rules applicable to such situations should be modified at this time.

Explanation of provision

Use of the installment method for accrual method dispositions

The installment method of accounting generally may not be used for dispositions of property that otherwise would be reported for Federal income tax purposes using an accrual method of accounting. The bill does not change present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming. The bill also does not change present law regarding the availability of the installment method for dispositions of timeshares and residential lots if the taxpayer elects to pay interest under section 453(l).

The bill does not change the ability of a cash method taxpayer to use the installment method. For example, a cash method individual who owns all of the stock of a closely held accrual method corporation sells his stock for cash, a ten year note, and a percentage of the gross revenues of the company for next ten years. Because the individual would otherwise report the disposition of the stock on the cash method, his ability to use the installment method in reporting the gain on the sale of the stock is not changed.

Modify pledge rule

The bill also modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. For example, a taxpayer disposes of property for an installment note. The disposition is properly reported using the installment method. The taxpayer only recognizes gain as it receives the deferred payments. However, were the taxpayer to pledge the installment note as security for a loan, the taxpayer would be required to treat the proceeds of such loan as a payment on the installment note and recognize the appropriate amount of gain. Under the bill, the taxpayer would also be required to treat the proceeds of a loan as payment on the installment note to the extent the taxpayer had the right to "put" or repay the loan by transferring the installment not to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner.

The modification of the pledge rule only applies to installment sales where the pledge rule of present law applies. Accordingly, the modified pledge rule does not apply to installment method sales made by a dealer in timeshares and residential lost where the taxpayer elects to pay interest under section 453(1)(2)(B), to sales of property used or produced in the trade or business of farming, or to dispositions where the sales price does not exceed $150,000, be-

cause such sales are not subject to the pledge rule under present law.

Effective date

The provision is effective for sales or dispositions on or after the date of enactment.

10. Add certain vaccines against streptococcus pneumoniae to the list of taxable vaccines (sec. 410 of the bill and sec. 4132 of the Code)

Present law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines recommended for routine administration to children: diphtheria, pertussis, tentanus, measles, mumps, rubella, polio, HIB (haemophilus type B), hepatitis B, varicella (chicken pox), and rotavirus gastroenteritis. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers and physicians. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

Reasons for change

Streptococcus pneumoniae (often referred to as pneumococcus) is a bacteria that can cause bacterial meningitis, a brain or spinal cord infection, bacteremia, a bloodstream infection, and otitis media (ear infection). The Committee understands that each year in the United States, pneumococcal disease accounts for an estimated 3,000 cases of bacterial meningitis, 50,000 cases of bacteremia, 500,000 cases of pneumonia, and 7 million cases of otitis media among all age groups. The Committee understands that, while there currently is a vaccine effective in preventing pneumococcal diseases in adults, that vaccine, a polysaccaride vaccine, does not induce an adequate immune response in young children and therefore does not protect children against these diseases. The Committee further understands that the Food and Drug Administration's (the "FDA") is expected to approve a new, conjugate vaccine against the disease and the Centers for Disease Control is expected to recommend this conjugate vaccine for routine inoculation of children. The Committee believes American children will benefit from wide use of this new vaccine. The Committee believes that, by including the new vaccine with those presently covered by the Vaccine Injury Compensation Trust Fund, greater application of the vaccine will be promoted. The Committee, therefore, believes it

is appropriate to add the conjugate vaccine against steprococcus pneumoniae to the list of taxable vaccines.

Explanation of provision

The bill adds any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines.

Effective date

The provision is effective for vaccine purchases beginning on the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children. No floor stocks tax is to be collected for amounts held for sale on that date. For sales on or before the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children for which delivery is made after such date, the delivery date is deemed to be the sale date.

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. 1134 as reported.

ESTIMATED BUDGET EFFECTS OF THE ''AFFORDABLE EDUCATION ACT OF 1999,'' AS APPROVED BY THE SENATE COMMITTEE ON FINANCE ON MAY 19, 1999

[Fiscal Years 2000–2009, in millions of dollars]

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000–2004	2000–2009
Education Relief Provisions:													
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; sunset 12/31/03; allow education IRA contributions for special needs beneficiaries above the age of 18; allow corporations and other entities to contribute to education IRAs; allow contributions until April 15 of the following year; and allow a taxpayer to exclude ED IRA distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; coordination with HOPE/Lifetime Learning credits sunsets 12/31/03 (thereafter earnings withdrawn do not receive tax-free treatment if HOPE/Lifetime Learning credit is claimed)	tyba 12/31/99	−50	−164	−251	−337	−355	−290	−278	−257	−226	−179	−1,156	−2,387
2. Qualified Tuition Plans—tax-free distributions from State plans; and allow private institutions to offer prepaid tuition plans, tax-deferred in 2000, with tax-free distributions beginning in 2004; allow a taxpayer to exclude State plan distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; coordination with HOPE/Lifetime learning credits sunsets 12/31/03 (thereafter earnings withdrawn do not receive tax-free treatment if HOPE/Lifetime Learning credit is claimed	tyba 12/31/99	−6	−22	−38	−57	−76	−94	−123	−152	−180	−209	−200	−959
3. Employer Provided Assistance—extend the exclusion for undergraduate courses through 6/30/04; add the exclusion for graduate level courses from 1/1/00 through 6/30/04	−1/1/00	−254	−510	−598	−637	−455	−122	–	–	–	–	−2,454	−2,577
4. Student Loan Interest—eliminate the 60 month rule for interest paid after 12/31/99	ipa 12/31/99	−16	−64	−69	−71	−74	−77	−78	−79	−87	−94	−295	−709
5. Eliminate the tax on awards under the National Health Corps Scholarship program and F. Edward Hebert Armed Forces Health Professions Scholarship program	tyba 12/31/93	−2	−1	−1	−1	(1)	(1)	−1	−1	−1	−1	−5	−8

Provision	Effective												
6. Increase arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million	tyba 12/31/99	(1)	−2	−4	−5	−13	−14	−14	−15	−16	−17	−25	−102
7. Issuance of tax-exempt private activity bonds for qualified education facilities with annual volume cap the greater of $10 per resident or $5 million	bia 12/31/99	−4	−16	−33	−52	−76	−103	−133	−163	−192	−220	−181	−992
8. Allow Federal Home Loan Bank to guarantee school construction bonds, capped at $500 million annually	bia 12/31/99	(1)	−1	−1	−1	−2	−2	−3	−3	−3	−3	−5	−19
Total of Education Relief Provisions		−332	−780	−995	−1,161	−1,051	−702	−630	−670	−705	−723	−4,321	−7,753
Possible Revenue Offset Provisions:													
1. 1-year carryback of foreign tax tax credits and 7-year carryforward	cai tyba 12/31/01			94	596	533	496	464	431	295	269	1,233	3,178
2. Limit use of non-accrual experience method of accounting to amounts to be received for the performance of qualified professional services	tyea DOE	12	77	60	33	28	10	12	14	16	18	210	280
3. Information reporting on cancellation of indebtedness by non-bank financial institutions	coda 12/31/99		7	7	7	7	7	7	7	7	7	28	63
4. Extension of IRS user fees through 9/30/09 [2]	9/30/03					50	53	56	59	61	64	50	343
5. Clarify the meaning of "subject to" liabilities under section 357(c)	to/a 10/19/98	19	14	16	18	20	22	24	26	28	30	87	217
6. Deny deduction for charitable spit dollar life insurance	(3)	13	13	14	15	15	16	17	18	19	20	70	159
7. Allow employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees (through 9/30/09)	tmi tyba 12/31/00		19	38	39	40	41	42	42	43	44	136	348
8. Impose limitation on pre-funding of certain employee benefits	cpa DOE	81	141	147	149	140	129	118	105	90	74	659	1,175
9. Repeal installment method for most accrual basis taxpayers; adjust pledge rules	iseio/a DOE	477	677	406	257	72	8	21	35	48	62	1,889	2,063
10. Include the Streptococcus Pneumonia vaccine in the Federal vaccine insurance program	(4)	4	7	9	10	10	10	10	10	10	11	39	91
Total of Possible Revenue Offset Provisions		606	955	791	1,124	915	792	771	747	617	599	4,391	7,917
Net Total		274	175	−204	−37	−136	90	141	77	−8	−124	70	164

[1] Loss of less than $500,000.
[2] Estimate provided by the Congressional Budget Office.

[3] Effective for transfers made after 2/8/99 and for premiums paid after the date of enactment.
[4] Effective for vaccine purchases the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated Streptococcus Pneumonia vaccines to children.

Legend for "Effective" column; bia=bonds issued after; cai=credits arising in; codea=cancellation of indebtedness after; cpa=contributions paid after; DOE=date of enactment; ipa=interest paid after; iseio/a=installment sales entered into on or after; tmi=transfers made in; to/a=transfer on or after; tyba=taxable years beginning after; tyea=taxable years ending after.

Note.—Details may not add 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 (other than the foreign tax credit carryover, information reporting, IRS user fees, and vaccine provisions) of the bill involve reduced tax expenditures (see Part III. A., above).

C. CONSULTATION 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, May 25, 1999.

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

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Affordable Education Act of 1999.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Hester Grippand.

Sincerely,

BARRY B. ANDERSON
for Dan L. Crippen, Director.

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

S. 1134—The Affordable Education Act of 1999

Summary: The Affordable Education Act of 1999 would amend the Internal Revenue Code to provide various tax incentives for education. The Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO) have estimated that this bill would increase revenues by $274 million in fiscal year 2000 and by $70 million over the 2000–2004 period. CBO estimates that the bill would increase direct spending by $3 million over the 2000–2004 period. Because the legislation would affect revenues and direct spending, pay-as-you-go procedures would apply.

The bill contains one intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). JCT estimates the cost of the new intergovernmental mandate would be less than $50 million in each fiscal year through the 2000–2004 period. The bill would impose eight new private-sector mandates. The costs of the

new mandates would exceed the threshold ($100 million in 1996, adjusted annually for inflation) specified in UMRA in fiscal years 2000–2004.

Description of major provisions: The Affordable Education Act of 1999 would modify education individual retirement accounts (IRAs) through provisions that would:

Expand the definition of qualified education expenses to include elementary and secondary schools through December 31, 2003;

Increase the annual contribution limit to $2,000 through December 31, 2003;

Allow contributions for special needs beneficiaries above the age of 18;

Allow corporations and tax-exempt entities to make contributions;

Allow contributions until the time prescribed by law for filing a return for such a taxable year;

Allow taxpayers to claim a HOPE or Lifetime Learning credit and to exclude amounts distributed from gross income through December 31, 2003; and

Repeal the excise tax on contributions made during any taxable year in which contributions are also made to a qualified state tuition program on behalf of the same beneficiary.

The bill would modify qualified tuition programs to:

Expand the definition of "qualified tuition program" to allow private institutions to provide prepaid tuition plans;

Exclude from gross income distributions made after December 31, 1999, from qualified state tuition programs and after December 31, 2003, distributions made by any qualified tuition program; and

Allow distributions from qualified tuition programs to be made on behalf of a student if a HOPE or Lifetime Learning Credit is claimed for that student.

The bill also contains other education tax incentives that would:

Extend the tax exclusion of employer-provided assistance for undergraduate courses through June 30, 2004, and allow the exclusion for graduate courses beginning on January 1, 2000, through June 30, 2004;

Eliminate the limit on the number of months for which interest paid on qualified education loans is deductible effective December 31, 1999;

Eliminate the tax on awards under the National Health Corps Scholarship program and the F. Edward Herbert Armed Forces Health Professions Scholarship program;

Increase the arbitrage rebate exemption from $10 million to $15 million on government bonds used to finance qualified school construction;

Allow the issuance of tax-exempt private activity bonds for public school facilities; and

Allow the Federal Housing Board to guarantee up to $500 million annually in school construction bonds through the Federal Home Loan Banks.

The bill contains revenue offsets that would:

Reduce the carryback period for foreign tax credits to one year and extend the foreign tax credit carryforward to 7 years;

Limit the use of the non-accrual experience method of accounting;

Expand the reporting of cancellation of indebtedness income to non-bank financial institutions;

Extnd IRS user fees through September 30, 2009;

Clarify the definition of "subject to" liabilities under section 357(c) of the Internal Revenue Code;

Deny charitable contribution deductions for transfers associated with split-dollar insurance arrangements;

Allow employers to transfer excess defined benefit plan assets to a special account for the health benefits of retirees through September 30, 2009;

Impose a limitation on prefunding of certain employee benefits;

Repeal the installment method for most accrual basis taxpayers; and

Include the streptococcus pneumonia vaccine in the list of taxable vaccines.

Estimated cost to the Federal Government: The estimated budgetary impact of the Affordable Education Act of 1999 is shown in the following table. The exclusion of employer-provided tuition assistance would affect social security taxes, which are off-budget.

	By fiscal year, in millions of dollars										
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
CHANGES IN REVENUES											
Educational provisions:											
On-budget	0	−237	−590	−772	−923	−881	−656	−630	−670	−705	−723
Off-budget	0	−95	−190	−223	−238	−170	−46	0	0	0	0
Subtotal	0	−332	−780	−995	−1,161	−1,051	−702	−630	−670	−705	−723
Revenue offset provisions	0	606	955	791	1,124	915	792	771	747	617	599
All revenue provisions:											
On-budget	0	369	365	19	201	35	136	141	77	−88	−124
Off-budget	0	−95	−190	−223	−238	−170	−46	0	0	0	0
Total	0	274	175	−204	−37	−136	−90	141	77	−88	−124
CHANGES IN DIRECT SPENDING											
IRS user fees	0	0	0	0	0	3	3	3	3	3	3
CHANGES IN SURPLUS											
On-budget	0	369	365	19	201	32	133	138	74	−91	−127
Off-budget	0	−95	−190	−223	−238	−170	−46	0	0	0	0
Total	0	274	175	−204	−37	−139	87	138	74	−91	−127

Sources: Joint Committee on Taxation and Congressional Budget Office.

Basis of estimate: The bill would extend through fiscal year 2009 the authority of the Internal Revenue Service (IRS) to charge taxpayers fees for certain rulings by the office of the chief counsel and by the office for employee plans and exempt organizations. CBO estimates that the extension of the IRS's authority to charge fees for such services, which is set to expire at the end of fiscal year 2003, would increase governmental receipts by $343 million over fiscal years 2004 through 2009, net of income and payroll tax offsets. CBO based its estimate on recent collections data and on information from the IRS. Because the IRS can retain and spend a portion of these fees without further appropriation action, CBO estimates

that extending the authority would also increase direct spending by $18 million over fiscal years 2004 through 2009. All other estimates were provided by JCT.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficient Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in governmental recipes and outlays that are subject to pay-as-you-go procedures are shown in the following table. Only changes affecting on-budget outlays and receipts (that is, those in non-Social Security programs) affect the pay-as-you-go scorecard. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

	By fiscal year, in millions of dollars										
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Changes in receipts	0	369	365	19	201	35	136	141	77	−88	−124
Changes in outlays	0	0	0	0	0	3	3	3	3	3	3

Estimated impact on State, local, and tribal governments: JCT has determined the provision in the Affordable Education Act of 1999 that would add streptococcus pneumonia to the list of taxable vaccines would impose a federal intergovernmental mandate on state, local, and tribal governments as defined in the Unfunded Mandates Reform Act (UMRA). JCT estimates that the direct costs of complying with this intergovernmental mandate will not exceed $50 million in any fiscal year through the 2000–2004 period. CBO and JCT have determined that the remaining provisions of the bill do not contain intergovernmental mandates as defined in UMRA.

Estimated impact on the private sector: JCT has determined that the Affordable Education Act of 1999 contains eight new private-sector mandates through provisions that would:

Reduce the carryback period for foreign tax credits to one year and extend the foreign tax credit carryforward to 7 years;

Limit the use of the non-accrual experience method of accounting;

Expand the reporting of cancellation of indebtedness income to non-bank financial institutions;

Clarify the definiton of "subject to" liabilities;

Deny charitable contribution deductions for transfers associated with split-dollar insurance arrangements;

Impose a limitation on prefunding of certain employee benefits;

Repeal the installment method for most accrual basis taxpayers; and

Include the streptococcus pneumonia vaccine in the list of taxable vaccines.

The direct costs of the new mandates would exceed the statutory threshold ($100 million in 1996, adjusted annual for inflation) established in UMRA in each of fiscal years 2000 though 2004. CBO and JCT have determined that the remaining provisions of the bill do not contain private-sector mandates as defined in UMRA.

ESTIMATED COST OF PRIVATE-SECTOR MANDATES

	By fiscal year, in millions of dollars—					
	1999	2000	2001	2002	2003	2004
Cost to the private sector	0	606	936	753	1,085	825

Source: Joint Committee on Taxation.

Estimate prepared by: Federal receipts: Hester Grippando; Federal spending: John Righter; Impact on Private sector: Keith Mattrick; Impact on State, Local, and Tribal Governments: Leo Lex.

Estimate approved by: Paul N. Van de Water, Assistant Director for Budget Analysis; G. Thomas Woodward, Assistant Director for Tax Analysis.

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 rollcall votes in the Committee's consideration of S. 1134.

Motion to report the bill

The bill (S. 1134) was ordered favorably reported, by a rollcall vote of 11 yeas and 5 nays (12–8, including proxy votes) on May 19, 1999. The vote, with a quorum present, was as follows:

Yeas.—Senators Roth, Grassley, Hatch, Murkowski, Nickles, Gramm, Lott, Mack, Thompson, Breaux, Graham, Kerry (proxy).

Nays.—Senators Chafee, Jeffords, Moynihan (proxy), Baucus, Rockefeller (proxy), Conrad, Bryan (proxy), Robb.

Votes on other amendments

An amendment by Senators Robb and Conrad to allow tax credits for holders of qualified school modernization bonds was defeated on a roll call vote of 8 yeas and 12 nays. The vote was as follows.

Yeas.—Senators Moynihan (proxy), Baucus, Rockefeller (proxy), Conrad, Graham, Bryan, Kerrey (Proxy), Robb.

Nays.—Senators Roth, Chafee, Grassley, Hatch, Murkowski, Nickles, Gramm, Lott, Jeffords, Mack, Thompson, Breaux.

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 1999 and before 2004), 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 cor-

porations and other entities to contribute to education IRAs, and makes certain technical corrections to the education IRS 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 permits private institutions to offer prepaid tuition plans.

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 through June 30, 2004.

The bill eliminates the 60-month limit for purposes of the deduction for interest paid on qualified student loans. The provision is effective for interest paid after December 31, 1999.

The bill provides an exclusion from gross income for awards under the National Health Corps Scholarship program and the F. Edward Hebert Armed Forces Health Professions Scholarship program, effective for taxable years beginning after December 31, 1993.

The bill increases the arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million, effective for bonds issued after December 31, 1999.

The bill permits the issuance of tax-exempt private activity bonds for qualified education facilities with an annual volume cap of the greater of $10 per resident or $5 million, effective for bonds issued after December 31, 1999.

The bill allows the Federal Home Loan Bank to guarantee up to $500 million annually for school construction bonds, effective for bonds issued after December 31, 1999.

The bill provides for the following revenue offsets to pay for the above-mentioned provisions: (1) reduce the carryback period for excess foreign tax credits from two years to one year, and extend the carryforward period for excess foreign tax credits from five years to seven years, effective for foreign tax credits arising in taxable years beginning after December 31, 2001; (2) limit the use of the non-accrual experience method of accounting to amounts to be received for the performance of qualified professional services, effective for taxable years ending after the date of enactment; (3) provide for information reporting on cancellation of indebtedness by non-bank financial institutions, effective for cancellation of indebtedness after December 31, 1999; (4) extend IRS use fees through September 30, 2009; (5) clarify the meaning of "subject to" liabilities under section 357(c), effective for transfers on or after October 19, 1998; (6) deny a charitable contribution deduction for charitable split dollar insurance, effective for transfers made after February 8, 1999, and for premiums paid after the date of enactment; (7) extend through September 30, 2009, the present-law provision allowing employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees; (8) impose limitations on the prefunding of certain employee benefits, effective for contributions paid after the date of enactment; (9) repeal the installment method

for most accrual basis taxpayers, effective for sales and other dispositions on or after the date of enactment; and (10) include the Streptococcus Pneumonia vaccine as a taxable vaccine in the Federal vaccine insurance program, effective for vaccine purchases the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated Streptococcus Pneumonia vaccines to children.

The 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, private prepaid tuition plans, employer-provided educational assistance programs, student loan interest, and National Health Service Corps and F. Edward Hebert Armed Forces Health Professions Scholarships. The increase in the arbitrage exception for public school bonds issued by certain State and local governments will reduce the burden of paying certain arbitrate 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 expense 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 as approved by the Committee on May 19, 1999. 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:

> 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.
>
> The use of the non-accrual experience method of accounting is limited to amounts to be received for the performance of qualified professional services.
>
> Information reporting is required with respect to cancellation of indebtedness by non-bank financial institutions.
>
> The meaning of “subject to” liabilities under section 357(c) is clarified.
>
> A charitable contribution deduction is denied for charitable split-dollar insurance.

Limitations are imposed on the prefunding of certain employee benefits.

The installment method of accounting is repealed for most accrual basis taxpayers.

The Streptococcus Pneumonia vaccine is subject to the vaccine excise tax.

The provision to impose the vaccine excise tax on the Streptococcus Pneumonia vaccine will impose a Federal intergovernmental mandate on State, local, or tribal governments of less than $50 million in the first fiscal year and in each of the four fiscal years following the first fiscal year.

The Committee has determined that it is necessary to include these provisions in the bill to provide revenue offsets for the education tax incentives approved by the Committee.

C. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code and that have "widespread applicability" to individuals or small businesses.

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

The undersigned Members of the Committee on Finance opposed the Affordable Education Act of 1999, as reported by the Finance Committee on May 19, 1999. We opposed the bill because, as explained below, we believe its central feature—the proposal to expand education IRAs—is seriously flawed. We were also troubled by the Committee's failure to comprehensively address in this bill the pressing need for improved school infrastructure in the states.

EMPLOYER PROVIDED EDUCATIONAL ASSISTANCE

The bill includes an extension of the 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.

The Finance Committee and Senate versions 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 June 30, 2004. We hope this position is sustained in the Senate bill, and in conference with the House.

QUALIFIED 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 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 plan rules were further modified in the Taxpayer Relief Act of 1997.

The proposal in the Committee bill to exclude certain distributions from qualified tuition plans from gross income would con-

tribute 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.

STUDENT LOANS

We also applaud the Committee for including a proposal to repeal the limit on the number of months during which interest paid on a student loan is deductible. Enactment of this proposal will eliminate significant complexity and administrative burden on the part of financial institutions, borrowers and the Internal Revenue Service.

EDUCATION IRAS

We appreciate the good intentions of the proponents of expanding the availability of education IRAs. 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 May 18, 1999, 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."

Previous Treasury 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 estimates that the average tax benefit to families with students attending public elementary and secondary schools would be $5.00 per year.

We therefore believe that the bill will not result in greater opportunity for middle and lower income families to send their 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. At a time when calls for simplifying, and even abolishing, the income tax grow ever louder, enactment of the proposed 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 ele-

mentary 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 IRA is made. For instance, after 2003, withdrawals for elementary and secondary education expenses can be made—but only from contributions made during the period from 2000 to 2003 (and from 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 (1999, 2000–2003, and post-2003), and from earnings on such contributions.

SCHOOL INFRASTRUCTURE

The bill includes a $5 million increase in the small government issuer exception to the arbitrage rebate requirement, provided the proceeds are used for school construction. In addition, the bill promotes public-private partnerships in school construction by allowing tax-exempt private activity bonds to be issued for public school facilities. While we applaud the inclusion of these provisions, they alone will not provide the financing tools to facilitate the school construction and modernization needs of our nation's school districts.

We believe that the amendment offered by Senator Robb and Senator Conrad in the Committee, to establish school modernization bonds, would provide substantial resources to address the pressing needs of school construction and repair. The proposal would authorize up to $25 billion in qualified school modernization bonds, holders of which would receive tax credits in lieu of an interest payment from the issuer of the bond. This proposal targets aid to the public schools with the greatest needs: those that are over-crowded and those that are in drastic need of repair. A portion of the bonds would benefit school districts with the highest percentage of low-income students. States would allocate the remaining bonds in a manner to efficiently leverage the tax incentive and maximize the number of districts able to build and repair schools.

Ninety percent of the students of this country attend public schools. The benefits of the K–12 education IRA proposal included in the bill would accrue principally to wealthier families whose children attend private schools. The Committee should have focused our limited resources on the public school system. The needs for school construction and modernization, including helping schools provide students with access to computers, are too great to ignore. We remain committed to identifying and pursuing solutions to this critical problem.

DANIEL P. MOYNIHAN.
MAX BAUCUS.
JOHN D. ROCKEFELLER.
KENT CONRAD.
RICHARD BRYAN.
CHARLES ROBB.