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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:	0	-237	-590	-772	-923	-881	-656	-630	-670	-705	-723
	--------	--------	--------	--------	---------	---------	--------	--------	--------	--------	--------
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:	0	369	365	19	201	35	136	141	77	-88	-124
	--------	--------	--------	--------	---------	---------	--------	--------	--------	--------	--------
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.

DESCRIPTION OF CHAIRMAN'S MARK OF PROPOSALS RELATING TO EDUCATION INCENTIVES

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

on May 19, 1999

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

May 17, 1999

JCX-20-99

CONTENTS

INTRODUCTION

The Senate Committee on Finance has scheduled a markup on May 19, 1999, on various education tax incentives.

This document,(1) prepared by the staff of the Joint Committee on Taxation, provides a description of the education tax incentives (Part I) and revenue offsets (Part II) contained in the Chairman's Mark.

I. EDUCATION TAX INCENTIVES

A. Modifications to Education Individual Retirement Accounts

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.(2) Contributions to education IRAs may be made only in cash. Annual contributions to education IRAs may not exceed $500 per designated beneficiary (except in cases involving certain tax-free rollovers, as described below), and may not be made after the designated beneficiary reaches age 18.(3) 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 other 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 includible 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.

Present law allows tax-free transfers or rollovers of account balances from one education IRA benefitting one beneficiary to another education IRA benefitting 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 will be deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses

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

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127. In addition, qualified higher education expenses do not include expenses paid with interest on education savings bonds that is excludable under section 135. 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.

Description of Proposal

Annual contribution limit

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

Qualified expenses

With respect to contributions made during the period 2000 through 2003 (and earnings attributable to such contributions), the proposal would expand 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 would be expanded to include "qualified elementary and secondary education expenses" meaning (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred in connection with the enrollment or attendance of the designated beneficiary 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. "Qualified elementary and secondary education expenses" also would 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 would be limited to post-secondary education expenses.

Special needs beneficiaries

The proposal also would provide 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 proposal, in the case of a special needs beneficiary, a deemed distribution of any balance in an education IRA would not occur when the beneficiary reaches age 30.

Contributions by persons other than individuals

The proposal would clarify that corporations and other entities (e.g., tax-exempt entities) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution. As under present law, the eligibility of high-income individuals to make contributions to education IRAs would be 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 proposal, individual contributors to education IRAs would be 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 in the case of individual taxpayers.

Coordination with HOPE and Lifetime Learning credits

The proposal would allow a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and receive an exclusion from gross income for 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 expenses for which a credit was claimed.

Coordination with qualified tuition plans

The proposal would repeal 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 proposals modifying education IRAs would generally be effective for taxable years beginning after December 31, 1999. The provision that increases 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 provision that expands the definition of qualified education expenses to include qualified elementary and secondary expenses applies to contributions (and earnings thereon) made during the period January 1, 2000, through December 31, 2003.

B. Private Pre-Paid Tuition Programs; Exclusion from Gross Income of Education Distributions from Qualified Tuition Programs

Present Law

Section 529 provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. The term "qualified higher education expenses" has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution[4], as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.

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 or another distributee (e.g., when a parent receives a refund) are included in the contributor's/distributee's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.(5)

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.(6) Contributors and beneficiaries are not allowed to directly or indirectly direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefitting one designated beneficiary to another account benefitting 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 or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

No amount is includible in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any contribution to or earnings on such a program until a distribution is made from the program, at which time the earnings portion of the distribution (whether made in cash or in-kind) is includible in the gross income of the distributee. 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).

Description of Proposal

Eligible educational institutions

The proposal would expand 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 would be able to purchase tuition credits or certificates on behalf of a designated beneficiary as set forth in section 529(b)(1)(A)(i), but would not be able to make contributions to an account as described in section 529(b)(1)(A)(ii) (so-called "savings account plans").

Exclusion from gross income

Under the proposal, an exclusion from gross income would be 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 would be 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. If a HOPE credit or Lifetime Learning credit is claimed with respect to a student for a taxable year, then a distribution from any qualified tuition program 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.

Rollovers for benefit of same beneficiary

The proposal would modify section 529(c)(3) to clarify that a transfer of credits (or other amounts) from one account benefitting a designated beneficiary to another account benefitting the same beneficiary will not be considered a distribution for a maximum of three such transfers.

Member of family

The proposal would modify section 529(e)(2) to clarify 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 proposal that would provide for the establishment of qualified tuition programs maintained by one or more private educational institutions would be effective for taxable years beginning after December 31, 1999. The proposal that would allow an exclusion from gross income for certain distributions from qualified State tuition programs under section 529 (and the modification to the definition of qualified higher education expenses under that section) is effective for distributions made in taxable years beginning after December 31, 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 proposal would be effective for distributions made in taxable years after December 31, 2003.

C. Exclusion for Employer-Provided Educational Assistance

Present Law

Educational expenses paid by an employer for its employees are generally deductible to 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.(7) 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.(8)

Description of Proposal

The proposal would extend the present-law exclusion for employer-provided educational assistance to undergraduate courses beginning before January 1, 2004. The proposal would also extend the exclusion to graduate education, effective for courses beginning after January 1, 2000, and before January 1, 2004.

Effective Date

The proposal to extend the exclusion for undergraduate courses would be effective for courses beginning before January 1, 2004. The exclusion with respect to graduate-level courses would be effective for courses beginning after January 1, 2000, and before June 1, 2004.

D. Eliminate 60-Month Limit on Student Loan Interest Deduction

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 the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending on at least a half-time basis (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs 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.(9) 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.

Description of Proposal

The proposal would eliminate the limit on the number of months during which interest paid on a qualified education loan is deductible.

Effective Date

The proposal would be effective for interest paid on qualified education loans after December 31, 1999.

E. Eliminate Tax on Awards Under National Health Corps Scholarship Program and F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program

Present Law

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

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

Section 134 provides that any "qualified military benefit," which includes any allowance, is excluded from gross income if received by a member or former member of the uniformed services if such benefit was excludable from gross income on September 9, 1986.

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 participants 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 underserved 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. These education awards generally involve the payment of higher education expenses (under the NHSC Program, the awards may be also used for the repayment or cancellation of existing or future student loans). 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.

Description of Proposal

The proposal would provide 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.

Effective Date

The proposal would be effective for education awards received after December 31, 1993.

F. Liberalize Tax-Exempt Financing Rules For Public School Construction

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 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 includible 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.

Description of Proposals

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 would be increased from $5 million to $10 million. Thus, these governmental units could issue up to $15 million of governmental bonds in a calendar year provided that at least $10 million of the bonds were used for public schools.

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

The private activities for which tax-exempt bonds may be issued would be 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 school facilities for which these bonds were issued would be required to be operated by a public educational agency as part of a system of public schools. Issuance of these bonds would be subject to an 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.

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

The Federal Housing Finance Board would be permitted to guarantee (through the 12 regional Federal Home Loan Banks in its system) up to $500 million per year of governmental bonds 95 percent or more of the proceeds of which are used for public school construction.

Effective Dates

The proposals would be effective for bonds issued after December 31, 1999.

II. REVENUE OFFSETS

A. Modify Foreign Tax Credit Carryover Rules

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.

Description of Proposal

The proposal would reduce the carryback period for excess foreign tax credits from two years to one year. The proposal also would extend the excess foreign tax credit carryforward period from five years to seven years.

Effective Date

The proposal would apply to foreign tax credits arising in taxable years beginning after December 31, 2001.

B. Limit Use of Non-Accrual Experience Method of Accounting to Amounts to be Received for the Performance of Qualified Personal Services

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 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, 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 heirs. Qualified personal service corporations are allowed to use the cash method without regard to whether their average annual gross receipts exceed $5 million.

Description of Proposal

The proposal would limit the use of the non-accrual experience method to amounts that are to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services would 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 non-accrual experience method would be conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount.

Effective Date

The proposal would be 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 would 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 would be taken into account over a period not to exceed four years under principles consistent with those in Rev. Proc. 98-60.(10)

C. Expand Reporting of Cancellation of Indebtedness Income

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 IRS regarding any discharge of indebtedness of $600 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 FDIC, the 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)).

The penalties for failure to file correct information reports with the IRS and to furnish statements to taxpayers are similar to those imposed with respect to a failure to provide other information returns. For example, 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.

Description of Proposal

The proposal would require that information reporting on discharges of indebtedness also be done 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 proposal would be effective with respect to discharges of indebtedness after December 31, 1999.

D. Extension of IRS User Fees

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[(11)] extended the statutory authorization for these user fees[(12)] through September 30, 2003.

Description of Proposal

The proposal would extend the statutory authorization for these user fees through September 30, 2009.

Effective Date

The proposal would be effective on the date of enactment.

E. Clarify Definition of "Subject to" Liabilities Under Code Section 357(c)

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.

Description of Proposal

Under the proposal, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability is generally eliminated. First, except as provided in 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 regulations, a nonrecourse liability is treated as having been assumed by the transferee of any asset subject to such liability; except that the amount treated as assumed shall be reduced by the amount of such liability which an owner of other assets not transferred to the transferee and also subject to such liability has agreed with the transferee to, and is expected to satisfy, up to the fair market value of such 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 will also 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, such increase shall not cause the basis to exceed the fair market value of the property (determined without regard to sec. 7701(g)). In addition, if gain is recognized to the transferor as the result of an assumption by a corporation of a nonrecourse liability that is also secured by any assets not transferred to the corporation, and if no person is subject to tax under the Internal Revenue Code 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.

The Treasury Department has authority to prescribe such regulations as may be necessary to carry out the purposes of the provision. Where appropriate, the Treasury Department may also prescribe regulations which provide that the manner in which a liability is treated as assumed under the provision is applied elsewhere in the Code.

The Miscellaneous Trade and Technical Corrections Act of 1999 (S. 262), as reported by the Senate Finance Committee on January 22, 1999, contains a substantially identical provision.

Effective Date

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

F. Denial of Charitable Contribution Deduction for Transfers Associated with Split-Dollar Insurance Arrangements

Present Law

Under present law, a deduction is allowed for a charitable contribution paid during the taxable year. A charitable contribution is defined to mean a contribution or gift to or for the use of specified types of organizations or governmental entities (sec. 170(c)).

Some taxpayers may be taking the position that a charitable contribution deduction is permitted under an arrangement whereby taxpayers transfer money to a charity, which the charity then uses to pay premiums for life insurance on the transferor or another person. Under these arrangements, the beneficiaries under the life insurance contract typically include members of the transferor's family (either directly or through a family trust or family partnership). The charitable organization does not have unfettered use of the transferred funds.

Description of Proposal

Deduction denial

The proposal(13) 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 proposal 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 proposal 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, 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 the payment of the charitable gift annuity, a person receiving payments under the charitable gift annuity from the charitable organization that are funded by the contract is not treated as an indirect beneficiary, provided certain requirements are met. The requirements are that (1) the charitable organization possess all of the incidents of ownership under the contract; (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). Only in the case in which the charitable organization purchases an annuity contract issued by an insurance company to fund the payment of the charitable gift annuity and the contract is purchased pursuant to the laws of a State that requires each annuitant under the charitable gift annuity to be an annuitant under the contract (in order for the State insurance laws not to apply to the charitable gift annuity), then the foregoing requirements (1) and (2) are treated as if they are met, provided that the State law requirement was in effect on February 8, 1999, each annuitant under the charitable gift annuity is a bona fide resident of the State, the only persons entitled to payments under the contract are persons entitled to payments under the charitable gift annuity, and the timing and amount of payments under the 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 purchases a contract issued by an insurance company, a person who is a recipient of an annuity or unitrust amount paid by the trust is not treated as an indirect beneficiary under the contract purchased by the trust, provided the foregoing requirements (1) and (2) (applied with respect to the trust) are met.

Nothing in the proposal 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 proposal imposes on any organization described in section 170(c) of the Code an excise tax, in the amount of the premiums paid by the organization on any life insurance, annuity, or endowment contract, if the payment of premiums on the contract is in connection with a transfer for which a deduction is not allowable under the deduction denial rule of the proposal. 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 proposal, 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 proposal requires that the 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 contract to which the premiums relate, as well as other information required by the Secretary of the Treasury. For this purpose, it is intended that a beneficiary include the 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 requirement. 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 proposal provides for the promulgation of regulations necessary to carry out the purposes of the provisions.

Effective Date

The deduction denial provision of the proposal applies to transfers after February 8, 1999 (as provided in H.R. 630). The excise tax provision of the proposal applies to premiums paid after the date of enactment. The reporting provision applies to premiums (that would be subject to the excise tax were it then effective) paid after February 8, 1999.

No inference is intended that a charitable contribution deduction is allowed under present law in the circumstances to which this proposal applies. The proposal 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 proposal.

G. Treatment of Excess Pension Assets Used for Retiree Health Benefits

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 may 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 may 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 heath 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 entitled 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.

Description of Proposal

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 would be extended through September 30, 2009.(14) In addition, the present-law minimum benefit requirement would be 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 or arrangement under which applicable health benefits are provided would be required to provide a minimum dollar level of retiree health expenditures for the taxable year of the transfer and the following 4 taxable years. The minimum dollar level would be the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the transfer. The applicable employer cost for a taxable year would be 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 proposal would be 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.

H. Impose Limitation on Prefunding of Certain Employee Benefits

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 deduction 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 severance pay benefits, or 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 employers, and (3) the plan does not maintain experience-rating arrangements with respect to individual employers.

Description of Proposal

Under the proposal, the present-law exception to the deduction limit for 10-or-more employer plans would be limited to plans that provide only medical, disability, and group-term life insurance benefits. This exception would no longer be 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 deduction limits (sections 419 and 419A) would apply to plans providing these benefits.

In addition, rules would be included to prevent amounts that are deductible pursuant to the 10-or-more employer exception (and earnings thereon) from being used to provide benefits other than medical, disability, and group-term life insurance.

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

Effective Date

The proposal would be effective with respect to contributions paid after the date of enactment.

I. Modify Installment Method and Prohibit its Use by Accrual Method Taxpayers

Present Law

An accrual method taxpayer is generally required to recognize income when all 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 if 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 method, except for sales of property that is 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[(15)] 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 rules require the payment of interest on the deferred tax that is attributable to most large installment sales.

Description of Proposal

Prohibit use of installment method for accrual method dispositions

The proposal generally would prohibit the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting.

The proposal 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 proposal also does not change present law regarding the availability of the installment method for dispositions of timeshares and residential taxpayers if the taxpayer elects to pay interest under section 453(l)(3).

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

Modify pledge rule

The proposal would also modify 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 payment. However, were the taxpayer to pledge the installment note as security for a loan, it 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 proposal, 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 repay the loan by transferring the installment note to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner.

The proposed modification of the pledge rule would only apply to installment sales where the pledge rule of present law applies. Accordingly, the proposal would not apply to installment method sales made by a dealer in timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(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, since such sales are not subject to the pledge rule under present law.

Effective Date

The proposal would be effective for installment sales entered into on or after the date of enactment.

J. Add Certain Vaccines Against Streptococcus Pneumonia to the List of Taxable Vaccines

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, varicella (chicken pox), and rotavirus gastroenteritis. The tax applies 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. 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.

Description of Proposal

The proposal would add conjugated streptococcus pneumonia vaccines to the list of taxable vaccines.

Effective Date

The proposal would be 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 would be collected for amounts held for sale on that date.

FOOTNOTES

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1. This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Mark of Proposals Relating to Education Incentives* (JCX-20-99) May 17, 1999.

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

3. 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.

4. "Eligible educational institutions" are defined the same for purposes of education IRAs (described in Part A, above) and qualified State tuition programs.

5. 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.

6. 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.

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

8. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction 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.

9. The maximum allowable deduction for 1998 was $1,000.

10. 1998-51 I.R.B. 16.

11. 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).

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

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

14. In addition to amendments to the Internal Revenue Code, the proposal would make conforming amendments to applicable sections of the Employee Retirement Income Security Act ("ERISA").

15. The net proceeds equal the gross loan proceeds less the direct expenses of obtaining the loan.

Joint Committee on Taxation
May 19, 1999
JCX-22-99

DESCRIPTION OF MODIFICATION TO CHAIRMAN'S MARK OF PROPOSALS RELATING TO EDUCATION INCENTIVES

The Senate Committee on Finance has scheduled a markup on May 19, 1999, on various education tax incentives in an original bill, entitled the "Affordable Education Act of 1999." A description of the Chairman's Mark is contained in *Description of Chairman's Mark of Proposals Relating to Education Incentives* (JCX-20-99), May 17, 1999.

Under the modification, a taxpayer would be permitted to claim a HOPE or Lifetime Learning credit for a taxable year and receive an exclusion from gross income for amounts distributed (both the principal and earnings portions) from an education individual retirement account and/or from a qualified tuition program on behalf of the same student in the same year as long as the distributions are not used for the same expenses for which a credit was claimed. This modification would be effective for distributions made during the period January 1, 2000, through December 31, 2003.

Under the modification, the exclusion for employer-provided education assistance, as applied to both graduate and undergraduate education, would be extended through courses beginning on or before June 30, 2004.[1]

FOOTNOTE

1. The *Description of Chairman's Mark of Proposals Relating to Education Incentives* (JCX-20-99), May 17, 1999, at p. 11 under the heading "Effective Date," incorrectly states that the Chairman's Mark would extend the exclusion for graduate-level courses to courses beginning after January 1, 2000, and before June 1, 2004. The effective date is correctly stated, at p. 11 under the "Description of Proposal," as graduate-level courses beginning after January 1, 2000, and before January 1, 2004.

May 18, 1999

Honorable William V. Roth, Jr.
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We write to express our strong opposition to proposals for education tax incentives (Joint Committee on Taxation, "Description of Chairman's Mark of Proposals Relating to Education Incentives" (JCX-020-99), May 17, 1999), which we understand your committee will consider this week. In the summer of 1997, as Congress was in the final stages of consideration of the Taxpayer Relief Act of 1997, the President stated that he would veto the legislation if it contained a proposal relating to Education Savings Accounts that is similar to the education savings account proposal contained in the Chairman's mark. In 1998, we wrote to inform you that we would recommend to the President that he veto similar legislation, which, after consideration and approval by Congress, he did. If this proposal were to pass the Congress this year, we again would recommend to the President that he veto the bill.

Every American child deserves a high-quality elementary and secondary education. We believe that targeting our limited Federal resources to build stronger public schools will help ensure that all our children receive the education they need to be productive citizens. Public schools serve approximately 90 percent of students in grades K-12 and currently face record-breaking enrollments. By focusing resources on public schools, we can leverage community investment to help parents, teachers, and administrators meet the important educational challenges they face in serving the vast majority of our children: meeting high standards for learning and discipline; fixing school buildings; and providing a safe, drug-free environment for children. [For this reason, the President's FY 2000 budget proposals include a school modernization bond initiative that would leverage $25 billion to renovate and build up to 6,000 public schools. In contrast, the Chairman's mark falls far short of adequately addressing the overwhelming problems that States and local communities face in building and modernizing their schools.]

The current bill disproportionately benefits the most affluent families and provides little benefit to lower- and middle-income families. Additionally, given the expansion of tax-preferred savings vehicles in the Taxpayer Relief Act of 1997, which the Administration supported, we do not believe that further increasing the contribution limits for Education IRAs will generate much additional savings. Instead, the Chairman's mark would reward families, particularly those with significant means, for what they may do in any case.

We are also concerned that the bill would create significant compliance problems. The legislation allows tax-free withdrawals from Education IRAs for, among other things, tuition, fees, academic tutoring, special needs services, books, supplies and equipment expenses incurred in connection with the child's enrollment or attendance at a public or private elementary or secondary school. Withdrawals would also be tax-free if used for room and board, uniforms, transportation or supplementary items or services required or provided by the school.

Distinguishing between an appropriately tax-free withdrawal and one that should be subject to tax would lead to significant additional record-keeping burdens for families and schools, as well as disputes when discretionary purchases are made.

In addition to the points outlined above, we have other concerns with proposals in the bill that are not described in this letter.

We understand that Senators Robb and Conrad intend to offer a substitute that would replace the education IRA proposals in this bill with school modernization/construction bond proposals similar to those in the President's budget for fiscal year 2000. We strongly prefer that proposal and other alternatives that devote Federal revenue to improving the public schools so that a high-quality education is available to every American child regardless of his or her family income. Therefore, we strongly support the Robb-Conrad substitute.

Thank you for letting us bring our concerns to your attention, and we look forward to working with you on these important budget and tax issues in the days ahead.

Sincerely,

Robert E. Rubin
Secretary of the Treasury

Dick Riley

Richard W. Riley
Secretary of Education

Karen Robb
02/22/2000 09:41:09 PM

Record Type: Record

To: Charles M. Brain/WHO/EOP@EOP

cc: Rebecca Hunter/WHO/EOP@EOP, Rebecca Hunter/WHO/EOP@EOP, Joanna E. Slaney/WHO/EOP@EOP

Subject: S. 1134, the Affordable Education Act of 1999

Lott may seek u.c. on this bill tomorrow. Because the prospects of getting u.c. are slim to none the Senate is not likely to debate this until next week at the earliest. This bill is $8 billion package of education tax initiatives. (While this bill contains revenue offsets that cover the costs of the bill, $2.5 billion were already used last year in the tax extender bill). This bill is similar to one passed by the Congress and vetoed by the President in 1998. Below is a list of key provisions, the most controversial is the Education Savings accounts (IRAs). According to Moynihan's staff the remainder of the provisions have bipartisan support.

Education Savings Accounts--this authorizes an increase in educ. svgs accts from $500-$2,000 and authorizes tax free distributions for K-12 education and homeschooling--currently only higher education expenses qualify. In 1997, the Pres. threatened to veto this in the Taxpayer Relief Act. These IRAs are not only objectionable because they favor the wealthy but they are also seen as tantamount to a school voucher for private schools.

Prepaid Tuition Plans.--this authorizes the expansion of tax benefits of qualified state tuition plans to allow tax-free withdrawals for qualifed education expenses. This would also authorize the formation of private prepaid tuition plans with tax-free withdrawals begining in 2003.

Section 127--this authorizes an income exclusion for employer provided eduation assistance for graduate studies. This provision expired in 1996 and the undergraduate income exclusion will expire in Dec. of 2000. This bill extends to June 2004 the exclusion for undergraduate and graduate course work.

Student Loan Interest-- this provision would permit the deductibility of interest for the life of the loan. Currently, the interest is deductible for 60 months after the repayment of the loan begins.

MEMORANDUM FOR DEMOCRATIC TAX LAs

From: Russ Sullivan
Senate Finance Committee

Subject: Overview of Finance Committee Education Tax Bill

Date: Tuesday, February 22, 2000

The Senate leadership may move on Wednesday, February 23, 2000 to bring S.1134, the Affordable Education Act of 1999, to the Senate floor. This $8 billion package of education tax initiatives was marked up in the Finance Committee on May 19, 1999. It was reported out on a vote of 12-8 with all Republicans except Sens. Chafee and Jeffords supporting the bill and all Democrats except Sens. Breaux, Graham and Kerrey opposing the bill. The package is similar to the one passed by the Congress and vetoed by President Clinton in 1998. The bill is fully paid for with tax raisers, principally from the President's budget. Some of the provisions were enacted into law in the tax extenders package passed in November 1999. The bill contains the following provisions:

Education Savings Accounts (Education IRAs). The bill incorporates the so-called "Coverdell bill" through an increase in the annual contribution to education savings accounts from $500 to $2000 and by authorizing tax-free distributions for K-12 education and homeschooling expenses (currently, only higher education expenses qualify). The expansion would only be effective from 2000 to 2003; after that time annual contributions would be limited to $500, and K-12 withdrawals could only be made from contributions made during the period from 2000 and 2003 (and the earnings on such contributions). This K-12 withdrawal feature is by far the most controversial component in the bill. In 1997, President Clinton threatened to veto the Taxpayer Relief Act of 1997 if this provision had been included.

The bill would also allow post-age 18 contributions for special needs children, and permit businesses to establish education savings accounts (though no non-discrimination rules would be imposed). In addition, the bill would provide coordination rules between education savings accounts and the HOPE credit, allowing taxpayers to both exclude distributions from their education savings account from income and claim the HOPE credit, provided they are not used for the same expenses. These coordination rules expire in 2003. Senator Torricelli is the lead Democratic sponsor of this provision.

Prepaid Tuition Plans. The bill expands the tax benefits of qualified state tuition plans to allow tax-free withdrawals for qualified education expenses. The bill also would allow for the formation of private prepaid tuition plans with tax-free withdrawals beginning in 2003. The bill also contains coordination rules between the prepaid tuition plans and the HOPE credit. However, these coordination rules sunset in 2003. Senators Graham, McConnell and Sessions have championed these provisions.

Section 127. The income exclusion for employer-provided education assistance for graduate studies expired June 30, 1996. The provision will expire for undergraduate studies December 31, 2000. The bill would extend the provision through June 30, 2004 for both undergraduate and graduate course (effective for graduate courses on January 1, 2000). Senators Moynihan, Roth and others have championed this provision, which is included in the President's FY2001 budget.

School Construction. The package contains three school construction items. First, the bill would exempt up to $15 million in tax-exempt school construction bonds issued by small school districts from the anti-arbitrage rebate rule, thus allowing districts to earn a limited amount of arbitrage profits on their school construction bonds. Second, the bill includes a proposal to permit public private partnerships for school construction using private activity bonds (which are tax-exempt). Each state would receive bond authority of $10 per resident under a separate cap. Senators Graham and Grassley sponsored these provisions. Third, the bill would permit the Federal Housing Finance Board to guarantee school construction bonds. Senator Roth sponsored this provision.

Student Loan Interest. The bill includes a provision to eliminate the 60-month limit on deductibility of student loan interest. Under current law, a taxpayer may only deduct interest on his or her student loans for 60 months after the repayment obligation begins. The proposal would allow deductibility for the life of the loan. This proposal was included in President Clinton's FY2001 budget. Senators Baucus and Grassley have introduced legislation to accomplish this.

Revenue Offsets. A package of 10 revenue offsets, principally from the tax accounting and employee benefits areas pays for the bill. About half of these proposals were tax raisers included in the President's FY2000 budget. Four of the ten, raising $2.5 billion, were partially or wholly included in the Ticket to Work and Work Incentives Improvement Act of 1999..

House Bill. The House Ways & Means Committee has not yet taken up this or similar legislation this Congress.

Likely Changes By Proponents. If the bill were brought up, it is likely that the proponents would seek to modify the bill to not sunset provisions in 2003 and would seek to drop many or all of the revenue offsets. At the time the bill was marked up in the Finance Committee, most Members insisted on it being fully paid for. Since then, budget surplus estimates have emerged and Democrats and the Administration agreed to enact the tax extenders bill without fully paying for it.

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 contribute to tax simplification. Parents and students would be able to participate in the programs and withdraw funds for college expenses without having to determine which portion of the withdrawal represents earnings versus a return of contributions.

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

Nanda Chitre
01/18/2000 08:23:42 PM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

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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 elementary or secondary education. Yet the bill provides no guidance for the IRS to determine whether a computer (or use of the Internet) is used by a child for educational purposes or for entertainment, or by the child's parents for unrelated purposes.

The proposal would also add significant complexity by requiring taxpayers to make sophisticated financial calculations each time a withdrawal from the education 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.

O:\BAI\BAI00.241 S.L.C.

#2860 Kay Bailey Hutchison

AMENDMENT NO. ____ Calendar No. ____

Purpose: To establish the Careers to Classrooms Program.

IN THE SENATE OF THE UNITED STATES—106th Cong., 2d Sess.

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.

Referred to the Committee on ______________________ and ordered to be printed

Ordered to lie on the table and to be printed

AMENDMENT intended to be proposed by ______________

Viz:

At the appropriate place, insert the following:

SEC. ___. CAREERS TO CLASSROOMS.

(a) DEFINITIONS.—In this section:

(1) IN GENERAL.—The terms "elementary school", "local educational agency", "secondary school", and "Secretary" have the meanings given the terms in section 14101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 8801).

February 29, 2000
1:45 p.m.

S.1134 Amendments Filed

Senator Abraham

2825 **Deduction for Computer Donations To Schools (with Wyden).** Current law provides taxpayers with a deduction in an amount greater than the fair market value of a computer donated to K-12 schools if the computer is less than two years old. The proposal would extent the enhanced deduction to donations of computers up to three years old. Current law does not provide a credit for the donation of computers to schools or senior centers. Taxpayers may claim a charitable deduction if the recipient is a qualified organization. The amendment would provide a credit of up to 30% of qualified computer contributions to schools and senior centers. The credit would be increased to 50% if the recipient is located in an empowerment zone, enterprise community or Indian reservation.

Senator Collins

2954 **Deduction for Teacher Professional Development Expenses and Credit for Unreimbursed Expenses for Classroom Materials.** Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow an itemized deduction (not subject to the 2% floor) or a credit for unreimbursed professional development expenditures a teacher incurs. In addition, the amendment would provide a credit of up to $100 for unreimbursed costs associated with providing classroom materials.

Senator Coverdell

2839 **Provide Teachers Protection Against Certain Lawsuits.** [Judiciary Committee explanation pending]

2840 **Eliminate the Sunset of the ESA Contribution Limit Increase.** Due to revenue constraints, the Finance Committee bill provided for an increase to $2000 in allowable contributions to an ESA only through December 31, 2003. The amendment would make that increase permanent.

Senator Dodd

2850 **Eliminate the provision to allow EDAs for K-12 tuition and fees**. The amendment would disallow spending ESA withdrawals for K-12 tuition and fees. It would allow the tax-free withdrawals to be used for other purposes (e.g., computers, uniforms) at public and private schools.

2857 **$1.2 billion in funding for IDEA**. The amendment strikes the ESA provisions in the bill and appropriates the $1.2 billion in savings to carry out part B of the Individuals with Disabilities Education Act.

Senator Feinstein

2845 **Require States Receiving Federal Funds under ESEA to Implement Achievement Standards and Assess Student Performance in Meeting the Standards**. The amendment would require that State and local education agencies (1) implement State achievement standards in the core curriculum at key transition points, to be determined by the State, for all K-12 students and (2) assess student performance in meeting the State achievement standards in order to receive federal funds under ESEA.

2846 **Facilitate the Adoption of State Policies with Respect to Prohibiting the Practice of Social Promotion.** The amendment would preclude states from making ESEA funds available to a local educational agency unless the State demonstrates to the Secretary of Education that the State has adopted a policy prohibiting the practice of social promotion.

Senator Graham

2843 **Provide Offsets for the Entire Bill**. The bill reported out by the Finance Committee in May 1999 contained 10 revenue provisions raising $8 billion over 10 years. The Ticket To Work legislation enacted by Congress in November 1999 contained parts or all of five of these 10 revenue offsets. The remaining five offsets would raise approximately $5.5 billion over 10 years. The amendment would provide up to approximately $25 billion in additional revenues to cover the $2.5 billion shortfall currently in the bill and increased costs that might be added through amendments. The raisers include reinstating the superfund excise taxes, eliminating the lower-of-cost-or-market method of accounting for inventories and provisions to reduce tax benefits associated with corporate tax shelters.

2844 **Eliminate the Sunset on the Coordination Rules Between Qualified Tuition Programs and the Hope and Lifetime Learning Credits**. Under the bill, distributions from qualified state tuition plans would be tax free. The bill provides that taxpayers could only claim both tax-free treatment of qualified state tuition plan distributions and the Hope credit/Lifetime Learning credit if they are for different qualified expenses. Due to revenue constraints, this coordination provision sunsets December 31, 2003. The amendment makes the coordination rules permanent.

2847 **Provide Funds to Assist High-Poverty School Districts Meet their Teaching Needs.** The amendment would build on the Troops To Teachers initiative to provide a $5,000 grant to individuals willing to change to a teaching career and commit to teaching at least three years in low-income schools as defined under Title I of ESEA. The grants can be used toward the cost of courses and training necessary to become qualified teachers.

2848 **Expanded Opportunities for School Construction Financing.** Current law requires school districts issuing bonds to spend the proceeds of those bonds within three years or pay to the IRS the excess of interest earned on bond proceeds over the interest payments to holders of the bonds. The amendment would extend that spend-down period to four years. Under current law, financial institutions are limited in their ability to be holders of school construction bonds. The amendment would allow financial institutions to purchase school construction bonds issued by districts issuing no more than $25,000,000 in bonds.

<u>Senator Gramm</u>

2828 **Disallow Federal Home Loan Bank System Guarantee of School Construction Bonds**. Under current law, bonds cannot be tax exempt (meaning the interest is not taxable income to the bondholder) if the bonds are guaranteed by a federal government agency. The theory is that bonds should not receive two separate federal subsidies. Exceptions are made for certain bonds guaranteed by certain governmental entities under programs in existence when the rule was enacted. The Finance Committee bill contained a provision permitting the Federal Home Loan Bank System to guarantee up to $500 million per year in school construction bonds. The amendment would delete this provision from the bill.

<u>Senator Hatch</u>

2823 **Deduction for teacher expenses**. Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow an above-the-line deduction for teacher professional development and incidental costs. The teacher could claim a deduction for every dollar of qualified expenses.

2824 **Marriage Penalty in Student Loan Interest Deduction (with Mack).** Under current law, the deduction for interest on qualified student loans is phased out for single filers beginning at $40,000 and is not available for those with income above $55,000. For married filers, the phase-out range is $60,000-$75,000. The proposal would increase the phase-out trigger for married couples to $80,000 and extend the phase-out range to $110,000. The result would be phase-outs for joint filers that is twice that of single filers.

Senator Kennedy

2849 **Eliminate the Provisions to Allow ESAs for K-12 School Expenses at Private or Religious Schools.** The amendment would preclude taxpayers from receiving tax-free distributions from an ESA and using those funds for K-12 school expenses at private or religious schools. Expenditures for public school K-12 expenses would be permitted under the amendment.

2851 **Eliminate the provision to allow ESAs for K-12 expenses**. The amendment would eliminate the use of ESAs for any K-12 expenditure. Under the amendment, ESAs could only be used for higher education expenses.

Senator Kerry

NYF **Exclusion of National Service Educational Awards from Income**. Under current law, scholarship and grants generally are excludable from income. Because Americorps education awards are considered to represent payment for services rendered, they are currently includable in taxable income. The amendment would provide that Americorps education awards are scholarships for federal income tax purposes and may be excluded from income..

Senator Kyl

2841 **Allow an Above-the-Line Deduction or Credit for K-12 Teachers Who Provide Classroom Materials**. Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow either an above-the-line deduction or a credit for unreimbursed expenditures a teacher incurs to provide classroom materials. The credit would be limited to $100 per year. The deduction would not be limited.

2842 **Permit a $100 Credit for K-12 Teachers who Provide Classroom Materials.** Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow a credit for unreimbursed expenditures a teacher incurs to provide classroom materials. The credit would be limited to $100 per year.

<u>Senator Mack</u>

2827 **Marriage Penalty in the Reduction of Permitted ESA Contributions (with Hatch).** Under current law, the $500 annual contribution (raised to $2,000 in the bill) limit for ESAs is phased out ratably for single filers with modified adjusted gross income between $95,000 and $110,000. The phase out range for joint filers is $150,000 and $160,000 for joint returns. The amendment would increase the phase-out range for joint filers to $190,000 to $220,000, double the amount applicable to single filers.

<u>Senator Robb</u>

2829 **Eliminate the Use of ESAs for K-12 School Expenses at Private or Religious Schools.** Under the bill, individuals could withdraw funds tax-free from an ESA for qualified expenses at a public, private or home school. The amendment would deny the tax-free withdrawal for expenses at private, religious or home schools. Under the amendment, tax-free withdrawals would be available only for qualified expenses at public schools.

2830 **Tax Credit Bonds for School Modernization.** The amendment would establish a new program under which holders of qualified school modernization bonds would be allowed a tax credit generally equal to the market interest rate. The federal government would allocate $25 billion in qualified school modernization bonds to the states and designated school districts. The amendment would be paid for in part by eliminating the provision to allow tax-free ESA distributions for K-12 expenses.

<u>Senator Roth</u>

2831 **Substitute.**

2832 **Advance Effective Dates of Title I (Education Savings Incentives) By One Year.** The Finance Committee bill was reported out in May 1999 and made the changes to the ESAs and qualified state tuition plans effective for years after December 31, 1999. The amendment moves the effective date to taxable years beginning after December 31, 2000.

2833 **Modify Section 127 Provision to Reflect Intervening Action**. In May 1999, the Finance Committee reported a bill extending the provision allowing employer-provided education assistance to be excluded from employee's income from June 1, 2000 to June 30, 2004. In November 1999, Congress passed Ticket To Work legislation that included extension of certain tax provisions. The section 127 employer-provided education assistance exclusion was extended from June 1, 2000 to December 31, 2001. The technical amendment reflects that change in law. The provision would still be effective through June 30, 2004.

2834 **Advance Effective Dates of Title III (School Construction) By One Year.** The Finance Committee bill was reported out in May 1999 and made the provisions regarding school construction effective for bonds issued after December 31, 1999. The amendment moves the effective date to bonds issued after December 31, 2000.

2835 **Delete All The Revenue Raising Provisions**. The bill reported out by the Finance Committee in May 1999 contained 10 revenue provisions raising $8 billion over 10 years. In the Ticket To Work legislation enacted by Congress in November 1999 contained parts or all of five of these 10 revenue offsets. The remaining five offsets would raise approximately $5.5 billion over 10 years. The amendment would strike all of the revenue raisers from the legislation.

2836 **Advance the Effective Date of the Provision Eliminating the 60-Month Limit on the Deductibility of Student Loans.** The Finance Committee bill was reported out in May 1999 and made the provision eliminating the 60-month limit on the deductibility of interest on qualified student loans effective for interest paid after December 31, 1999. The amendment moves the effective date to interest paid on qualified education loans after December 31, 2000.

Senator Torricelli

2826 **$5000 Per Year Certified Teacher Credit**. Current law does not provide a credit or other tax subsidy for certified teachers. The amendment would permit certain certified teachers to claim a tax credit of up to $5000 each year. under the amendment, certified teachers would be individuals who have successfully completed the requirements for advanced certification provided by the National Board for Professional Teaching Standards. The credit would be limited to teachers serving in certain urban and rural areas. The credit would be refundable, meaning that if the teacher's tax liability without the credit were $4,000, then the teacher would have a tax liability of $0 and would also receive a refund of $1,000 from the IRS.

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98 VOTE 59 – 36

Toricelli JCT tax # 70% benefit bottom 70%

S115 Muntz / JT 78% + 93$ FEI

D's LOST '98

Biden
Breaux
Byrd
Cleland
Feinstein
Kohl
Lieberman
Toricelli /8

D pick-up

Schumer /1

Likely D lost

Graham

D unknown

Lincoln (Bumpers)
Leaning Y EDWARDS (FAIRCLOTH)
leaning Y BAYH (COATS)

R gain

2 ✓ Voinovich (Glenn)

R lost

Bunning (Ford)
Fitzgerald (Moseley-Braun)

R Nays

Chafee — Leaning Dem
Jeffords
Specter

VOTE

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	59	36	
w/NV	+1	+3	(JDR, Akaka, Baucus
	60	39	
	−1	+1	Schumer
	+1	−1	Graham
	60	39	
	−1	+1	Volnovich
	59	40	
	+2	−2	BUNNING + FITZGERALD
	61	38	
	−1	+1	LINCOLN
	60	39	

60-40
63-37

Q: SPECTER
CHAFEE
JEFFORDS
BAYH (A)
EDWARDS (A)

12 ½ pm

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S.L.C.

Connie Mack

PENDING

AMENDMENT NO. ____ Calendar No. ____

Purpose: To eliminate the marriage penalty in the reduction in permitted contributions to education individual retirement accounts.

IN THE Sess.

AMENDMENT Nº 2827

By Coverdell for Mack (Hatch)

To: S. 1134

2

Page(s)

GPO: 1996 52-517 (mac)

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Referred to the Committee on ____________
and ordered to be printed

Ordered to lie on the table and to be printed

AMENDMENT intended to be proposed by Mr. MACK and Mr. HATCH

Viz:

In subsection (a) of section 101, add at the end the following:

(4) ELIMINATION OF THE MARRIAGE PENALTY IN THE REDUCTION IN PERMITTED CONTRIBUTIONS.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) is amended—

(A) by striking "$150,000" in subparagraph (A)(ii) and inserting "$190,000", and

(B) by striking "$10,000" in subparagraph (B) and inserting "$30,000".

February 29, 2000
1:45 p.m.

S.1134 Amendments Filed

Senator Abraham

2825 **Deduction for Computer Donations To Schools (with Wyden).** Current law provides taxpayers with a deduction in an amount greater than the fair market value of a computer donated to K-12 schools if the computer is less than two years old. The proposal would extent the enhanced deduction to donations of computers up to three years old. Current law does not provide a credit for the donation of computers to schools or senior centers. Taxpayers may claim a charitable deduction if the recipient is a qualified organization. The amendment would provide a credit of up to 30% of qualified computer contributions to schools and senior centers. The credit would be increased to 50% if the recipient is located in an empowerment zone, enterprise community or Indian reservation.

Senator Collins

2954 **Deduction for Teacher Professional Development Expenses and Credit for Unreimbursed Expenses for Classroom Materials.** Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow an itemized deduction (not subject to the 2% floor) or a credit for unreimbursed professional development expenditures a teacher incurs. In addition, the amendment would provide a credit of up to $100 for unreimbursed costs associated with providing classroom materials.

Senator Coverdell

2839 **Provide Teachers Protection Against Certain Lawsuits.** [Judiciary Committee explanation pending]

2840 **Eliminate the Sunset of the ESA Contribution Limit Increase.** Due to revenue constraints, the Finance Committee bill provided for an increase to $2000 in allowable contributions to an ESA only through December 31, 2003. The amendment would make that increase permanent.

Senator Dodd

2850 **Eliminate the provision to allow EDAs for K-12 tuition and fees.** The amendment would disallow spending ESA withdrawals for K-12 tuition and fees. It would allow the tax-free withdrawals to be used for other purposes (e.g., computers, uniforms) at public and private schools.

2857 **$1.2 billion in funding for IDEA.** The amendment strikes the ESA provisions in the bill and appropriates the $1.2 billion in savings to carry out part B of the Individuals with Disabilities Education Act.

Senator Feinstein

2845 **Require States Receiving Federal Funds under ESEA to Implement Achievement Standards and Assess Student Performance in Meeting the Standards.** The amendment would require that State and local education agencies (1) implement State achievement standards in the core curriculum at key transition points, to be determined by the State, for all K-12 students and (2) assess student performance in meeting the State achievement standards in order to receive federal funds under ESEA.

2846 **Facilitate the Adoption of State Policies with Respect to Prohibiting the Practice of Social Promotion.** The amendment would preclude states from making ESEA funds available to a local educational agency unless the State demonstrates to the Secretary of Education that the State has adopted a policy prohibiting the practice of social promotion.

Senator Graham

2843 **Provide Offsets for the Entire Bill.** The bill reported out by the Finance Committee in May 1999 contained 10 revenue provisions raising $8 billion over 10 years. The Ticket To Work legislation enacted by Congress in November 1999 contained parts or all of five of these 10 revenue offsets. The remaining five offsets would raise approximately $5.5 billion over 10 years. The amendment would provide up to approximately $25 billion in additional revenues to cover the $2.5 billion shortfall currently in the bill and increased costs that might be added through amendments. The raisers include reinstating the superfund excise taxes, eliminating the lower-of-cost-or-market method of accounting for inventories and provisions to reduce tax benefits associated with corporate tax shelters.

2844 **Eliminate the Sunset on the Coordination Rules Between Qualified Tuition Programs and the Hope and Lifetime Learning Credits**. Under the bill, distributions from qualified state tuition plans would be tax free. The bill provides that taxpayers could only claim both tax-free treatment of qualified state tuition plan distributions and the Hope credit/Lifetime Learning credit if they are for different qualified expenses. Due to revenue constraints, this coordination provision sunsets December 31, 2003. The amendment makes the coordination rules permanent.

2847 **Provide Funds to Assist High-Poverty School Districts Meet their Teaching Needs**. The amendment would build on the Troops To Teachers initiative to provide a $5,000 grant to individuals willing to change to a teaching career and commit to teaching at least three years in low-income schools as defined under Title I of ESEA. The grants can be used toward the cost of courses and training necessary to become qualified teachers.

2848 **Expanded Opportunities for School Construction Financing.** Current law requires school districts issuing bonds to spend the proceeds of those bonds within three years or pay to the IRS the excess of interest earned on bond proceeds over the interest payments to holders of the bonds. The amendment would extend that spend-down period to four years. Under current law, financial institutions are limited in their ability to be holders of school construction bonds. The amendment would allow financial institutions to purchase school construction bonds issued by districts issuing no more than $25,000,000 in bonds.

<u>Senator Gramm</u>

2828 **Disallow Federal Home Loan Bank System Guarantee of School Construction Bonds**. Under current law, bonds cannot be tax exempt (meaning the interest is not taxable income to the bondholder) if the bonds are guaranteed by a federal government agency. The theory is that bonds should not receive two separate federal subsidies. Exceptions are made for certain bonds guaranteed by certain governmental entities under programs in existence when the rule was enacted. The Finance Committee bill contained a provision permitting the Federal Home Loan Bank System to guarantee up to $500 million per year in school construction bonds. The amendment would delete this provision from the bill.

<u>Senator Hatch</u>

2823 **Deduction for teacher expenses**. Under current law, a teacher (or any other taxpayer) may only deduct unreimbursed business expenses to the extent that, in the aggregate, they exceed 2% of adjusted gross income. The amendment would allow an above-the-line deduction for teacher professional development and incidental costs. The teacher could claim a deduction for every dollar of qualified expenses.

2824 **Marriage Penalty in Student Loan Interest Deduction (with Mack).** Under current law, the deduction for interest on qualified student loans is phased out for single filers beginning at $40,000 and is not available for those with income above $55,000. For married filers, the phase-out range is $60,000-$75,000. The proposal would increase the phase-out trigger for married couples to $80,000 and extend the phase-out range to $110,000. The result would be phase-outs for joint filers that is twice that of single filers.

Senator Kennedy

2849 **Eliminate the Provisions to Allow ESAs for K-12 School Expenses at Private or Religious Schools.** The amendment would preclude taxpayers from receiving tax-free distributions from an ESA and using those funds for K-12 school expenses at private or religious schools. Expenditures for public school K-12 expenses would be permitted under the amendment.

2851 **Eliminate the provision to allow ESAs for K-12 expenses**. The amendment would eliminate the use of ESAs for any K-12 expenditure. Under the amendment, ESAs could only be used for higher education expenses.

Senator Kerry

NYF **Exclusion of National Service Educational Awards from Income**. Under current law, scholarship and grants generally are excludable from income. Because Americorps education awards are considered to represent payment for services rendered, they are currently includable in taxable income. The amendment would provide that Americorps education awards are scholarships for federal income tax purposes and may be excluded from income..

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