105TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
105–332

EDUCATION SAVINGS ACT FOR PUBLIC AND PRIVATE SCHOOLS

OCTOBER 21, 1997.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ARCHER, from the Committee on Ways and Means, submitted the following

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 2646]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 2646) to amend the Internal Revenue Code of 1986 to allow tax-free expenditures from education individual retirement accounts for elementary and secondary school expenses, to increase the maximum annual amount of contributions to such accounts, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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59–006

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Education Savings Act for Public and Private Schools".

SEC. 2. MODIFICATIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) TAX-FREE EXPENDITURES FOR ELEMENTARY AND SECONDARY SCHOOL EXPENSES.—

(1) IN GENERAL.—Section 530(b)(2) of the Internal Revenue Code of 1986 is amended to read as follows:

"(2) QUALIFIED EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified education expenses' means—

"(i) qualified higher education expenses (as defined in section 529(e)(3)), and

"(ii) qualified elementary and secondary education expenses (as defined in paragraph (4)).

Such expenses shall be reduced as provided in section 25A(g)(2).

"(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account, under a qualified State tuition program (as defined in section 529(b)) for the benefit of the beneficiary of the account."

(2) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—Section 530(b) of such Code is amended by adding at the end the following new paragraph:

"(4) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified elementary and secondary education expenses' means tuition, fees, tutoring, special needs services, books, supplies, computer equipment (including related software and services) and other equipment, transportation, and supplementary expenses required for the enrollment or attendance of the designated beneficiary of the trust at a public, private, or religious school.

"(B) SPECIAL RULE FOR HOMESCHOOLING.—Such term shall include expenses described in subparagraph (A) required for education provided for homeschooling if the requirements of any applicable State or local law are met with respect to such education.

"(C) SCHOOL.—The term 'school' means any school which provides elementary education or secondary education (through grade 12), as determined under State law."

(3) CONFORMING AMENDMENTS.—Subsections (b)(1) and (d)(2) of section 530 of such Code are each amended by striking "higher" each place it appears in the text and heading thereof.

(b) INCREASE IN MAXIMUM ANNUAL CONTRIBUTIONS.—

(1) IN GENERAL.—Section 530(b)(1)(A)(iii) of the Internal Revenue Code of 1986 is amended by striking "$500" and inserting "$2,500".

(2) CONFORMING AMENDMENTS.—

(A) Section 530(d)(4)(C) of such Code is amended by striking "$500" and inserting "$2,500".

(B) Section 4973(e)(1)(A) of such Code is amended by striking "$500" and inserting "$2,500".

(c) WAIVER OF AGE LIMITATIONS FOR CHILDREN WITH SPECIAL NEEDS.—Paragraph (1) of section 530(b) of the Internal Revenue Code of 1986 is amended by adding at the end the following flush sentence:

"The age limitations in the preceding sentence shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary)."

(d) CORPORATIONS PERMITTED TO CONTRIBUTE TO ACCOUNTS.—Paragraph (1) of section 530(c) of the Internal Revenue Code of 1986 is amended by striking "The maximum amount which a contributor" and inserting "In the case of a contributor who is an individual, the maximum amount the contributor".

(e) EFFECTIVE DATE; REFERENCES.—

(1) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 213 of the Taxpayer Relief Act of 1997.

(2) REFERENCES.—Any reference in this section to any section of the Internal Revenue Code of 1986 shall be a reference to such section as added by the Taxpayer Relief Act of 1997.

SEC. 3. OVERRULING OF SCHMIDT BAKING COMPANY CASE.

(a) IN GENERAL.—The Internal Revenue Code of 1986 shall be applied (other than with respect to severance pay) without regard to the result reached in the case of Schmidt Baking Company, Inc. v. Commissioner of Internal Revenue, 107 T.C. 271 (1996).

(b) REGULATIONS.—The Secretary of the Treasury or the Secretary's delegate shall prescribe regulations to reflect subsection (a).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Subsections (a) and (b) shall apply to taxable years ending after October 8, 1997.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by this section to change its method of accounting for its first taxable year ending after October 8, 1997—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account in such first taxable year.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

H.R. 2646, as amended, would expand and modify the education savings accounts enacted in the Taxpayer Relief Act of 1997 ("1997 Act") to include elementary and secondary education expenses. The bill also provides a revenue offset relating to the treatment of the employer deduction for vacation pay.

B. BACKGROUND AND NEED FOR LEGISLATION

The bill, as amended, expands the opportunity for use of education savings accounts to include elementary and secondary school expenses and increases the amount that may be deductible to such accounts. The expansion of the education savings account is paid for by modifying the treatment of the employer deduction for vacation pay.

C. LEGISLATIVE HISTORY

H.R. 2646 [1] was introduced by Chairman Archer and Speaker Gingrich on October 9, 1997, and was amended by the Committee in a markup on October 9, 1997. An amendment in the nature of a substitute (offered by Chairman Archer) was adopted by a voice vote, with a quorum present. The bill, as amended, was ordered fa-

[1] An earlier, similar version of this bill was introduced by Speaker Gingrich and others on August 1, 1997, as H.R. 2373 ("Parents and Students Savings Account Plus Act").

vorably reported by a roll call of 19 yeas and 17 nays on October 9, 1997, with a quorum present.

II. EXPLANATION OF THE BILL

A. Education Savings Act for Public and Private Schools (sec. 2 of the bill and sec. 530 of the Code)

PRESENT LAW

Code section 530—enacted as part of the Taxpayer Relief Act of 1997 ("1997 Act')— provides that taxpayers may establish "education IRAs," meaning certain trusts or custodial accounts created exclusively for the purpose of paying qualified higher education expenses of a named beneficiary. Annual contributions to education IRAs may not exceed $500 per designated beneficiary, and may not be made after the designated beneficiary reaches age 18. Contributions to an education IRA may not be made by certain higher-income taxpayers—i.e., the contribution limit is phased out for individuals with modified adjusted gross income between $95,000 and $110,000 ($150,000 and $160,000 for taxpayers filing joint returns). No contribution may be made to an education IRA during any year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary. [2]

Until a distribution is made from an education IRA, earnings on contributions to the account generally are not subject to tax. [3] In addition, distributions from an education IRA are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred by the beneficiary 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). [4] The earnings portion of an education IRA distribution not used to pay qualified higher education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax. [5] However, the additional 10-percent tax does not apply if a distribution is

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[2] Consistent with the legislative history to the 1997 Act, a technical correction is needed to provide that any balance remaining in an education IRA will be deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

[3] However, education IRAs are subject to the unrelated business income tax ("UBIT") imposed by section 511.

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

[5] This 10-percent additional tax does not apply if a distribution from an education IRA is made on account of the death, disability, or scholarship received by the designated beneficiary.

made of excess contributions above the $500 limit (and any earnings attributable to such excess contributions) if the distribution is made on or before the date that a return is required to be filed (including extensions of time) by the contributor for the year in which the excess contribution was made.[6] In addition, section 530 allows tax-free rollovers of account balances from an education IRA benefiting one family member to an education IRA benefiting another family member. Section 530 is effective for taxable years beginning after December 31, 1997.

The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an "eligible educational institution" (defined by reference to sec. 481 of the Higher Education Act of 1965 and generally including accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, another recognized post-secondary credential and including certain proprietary and vocational institutions). The institution must be eligible to participate in Department of Education student aid programs. Certain room and board expenses also may be qualified higher education expenses, but only if the student is enrolled at an eligible educational institution on at least a half-time basis. Qualified higher education expenses do not include elementary or secondary school expenses.

REASONS FOR CHANGE

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

EXPLANATION OF PROVISIONS

The bill increases to $2,500 the present-law annual contribution limit of $500 that currently applies to education IRAs. Thus, under the bill, aggregate contributions that could be made by all contributors to one (or more) education IRAs established on behalf of any particular designated beneficiary are limited to $2,500 per year.

In addition, the bill expands the definition of qualified education expenses that may be paid with tax-free distributions from an education IRA. Specifically, the definition of qualified education expenses is expanded to include "qualified elementary and secondary education expenses," meaning tuition, fees, tutoring, special needs services, books, supplies, computer equipment (including related software and services) and other equipment, transportation, and supplementary expenses required for the enrollment or attendance

[6] A technical correction to the 1997 Act is needed to clarify that the additional 10- percent tax will not apply to the distribution of any contribution to an education IRA made during a taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

of a designated beneficiary at a public, private, or religious elementary or secondary school (through grade 12). "Qualified elementary and secondary education expenses" also include homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling.

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

Further, the bill clarifies that corporations are permitted to make contributions to education IRAs, regardless of the income of the corporation during the year of the contribution. As under present law, certain higher-income individuals are not eligible to make contributions to an education IRA.

EFFECTIVE DATE

The provisions are effective for taxable years beginning after December 31, 1997.

B. EMPLOYER DEDUCTIONS FOR VACATION PAY (SEC. 3 OF THE BILL)

PRESENT LAW

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

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

The Tax Court recently addressed the issue of when vacation pay and severance pay are considered deferred compensation in *Schmidt Baking Co., Inc.,* 107 T.C. 271 (1996). In *Schmidt Baking,* the taxpayer was an accrual basis taxpayer with a fiscal year that ended December 28, 1991. The taxpayer funded its accrued vacation and severance pay liabilities for 1991 by purchasing an irrevocable letter of credit on March 13, 1992. The parties stipulated that the letter of credit represented a transfer of substantially vested interest in property to employees for purposes of section 83, and that the fair market value of such interest was includible in the employees' gross incomes for 1992 as a result of the transfer.[7] The Tax Court held that the purchase of the letter of credit, and the resulting income inclusion, constituted payment of the vacation and severance pay within the 2½ month period. Thus, the vacation and severance pay were treated as received by the employees within the 2½-month period and were not treated as deferred compensation. The vacation pay and severance pay were deductible by the taxpayer for its 1991 fiscal year pursuant to its normal accrual method of accounting.

REASONS FOR CHANGE

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

The tax treatment of vacation pay was again changed in the Omnibus Budget Reconciliation Act of 1987 ("OBRA 1987"). At that time, the Congress was concerned that then-present law provided more favorable tax treatment for vacation pay that was deferred by employees beyond the end of the year than was provided for other deferred benefits. The House and Senate bills would have repealed the reserve for accrued vacation pay and would have provided that deductions for vacation pay generally would be allowed in any taxable year for amounts paid during the year, plus vested vacation amounts paid or funded within 2½ months after the end of the year. The conference agreement followed a different approach, and provided that "vacation pay earned during any taxable year, but not paid to employees on or before the date that is 2½ months after the end of the taxable year, is deductible for the taxable year of the employer in which it is paid to employees."[8] The key difference between the House and Senate provisions and the conference agreement to OBRA 1987 is that the conference agreement does now allow a deduction for amounts that vest and are funded

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

[8] H. Rept. 100–495, 921 (Dec. 21, 1987).

(i.e., are includible in income) within 2½ months after the end of the employer's taxable year.

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

Further, the Committee is concerned that taxpayers may inappropriately extend the rationale of *Schmidt Baking* to other situations in which a deduction or other tax consequences are contingent upon an item being paid. The Committee does not believe that, as a general rule, letters of credit and similar mechanisms should be considered payment for any purposes of the Code.

EXPLANATION OF PROVISION

The bill specifically overrules the result in *Schmidt Baking* and provides that, except with respect to severance pay,[9] the Internal Revenue Code will be applied without regard to the result reached in that case. Thus, under the bill, the fact that an item is includible in income is not taken into account in determining whether or not payment has been made. For example, with respect to the determination of whether an item of compensation (other than severance pay) is deferred compensation, the fact that the item is includible in the income of employees within the applicable 2½ month period is not taken into account in determining whether there has been payment or receipt by the employees. Rather, the item must have been actually paid or received within the 2½ month period in order for the compensation not to be treated as deferred compensation.

While *Schmidt Baking* involved only vacation pay and severance pay, there is concern that this type of arrangement may be tried to circumvent other provisions of the Code where payment is required in order for a deduction to occur. Thus, the provision is not limited to vacation pay or the determination of whether compensation is deferred compensation.

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

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

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

Similarly, the provision does not affect situations in which payment is not required in order for a deduction to occur. Thus, the provision does not change the general rule that deferred compensation (other than deferred compensation provided through certain types of plans), other than vacation pay, is deductible in the taxable year in which it is includible in the gross income of employees participating in the plan.

EFFECTIVE DATE

The provision is effective for taxable years ending after October 8, 1997. Any change in method of accounting required by the provision is treated as initiated by the taxpayer with the consent of the Secretary of the Treasury. Any adjustment required by section 481 as a result of the change is taken into account in the year of the change.

III. VOTES OF THE COMMITTEE

In compliance with clause 2(l)(2)(B) of rule XI of the Rules of the House of Representatives, the following statements are made concerning the votes of the Committee on Ways and Means in its consideration of the bill H.R. 2646.

Motion to report the bill

The bill, H.R. 2646, as amended, was ordered favorably reported by a roll call vote of 19 yeas to 17 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Archer	X			Mr. Rangel		X	
Mr. Crane	X			Mr. Stark		X	
Mr. Thomas	X			Mr. Matsui		X	
Mr. Shaw	X			Mrs. Kennelly		X	
Mrs. Johnson		X		Mr. Coyne		X	
Mr. Bunning				Mr. Levin		X	
Mr. Houghton		X		Mr. Cardin		X	
Mr. Herger	X			Mr. McDermott		X	
Mr. McCrery	X			Mr. Kleczka		X	
Mr. Camp	X			Mr. Lewis		X	
Mr. Ramstad	X			Mr. Neal		X	
Mr. Nussle	X			Mr. McNulty		X	
Mr. Johnson	X			Mr. Jefferson		X	
Ms. Dunn	X			Mr. Tanner			
Mr. Collins	X			Mr. Becerra		X	
Mr. Portman	X			Mrs. Thurman		X	
Mr. English	X						
Mr. Ensign	X						
Mr. Christensen	X						
Mr. Watkins	X						
Mr. Hayworth	X						
Mr. Weller							
Mr. Hulshof	X						

Vote on amendment

An amendment by Mr. Rangel, that would strike the provision which expands education savings accounts and substitute a provision that modifies the education zone bond provisions of the Taxpayer Relief Act of 1997, to the Chairman's amendment in the nature of a substitute, was defeated by a roll call vote of 15 yeas to 20 nays. The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Archer		X		Mr. Rangel	X		
Mr. Crane		X		Mr. Stark	X		
Mr. Thomas		X		Mr. Matsui	X		
Mr. Shaw		X		Mrs. Kennelly	X		
Mrs. Johnson		X		Mr. Coyne	X		
Mr. Bunning				Mr. Levin	X		
Mr. Houghton		X		Mr. Cardin	X		
Mr. Herger		X		Mr. McDermott	X		
Mr. McCrery		X		Mr. Kleczka	X		
Mr. Camp		X		Mr. Lewis	X		
Mr. Ramstad		X		Mr. Neal	X		
Mr. Nussle		X		Mr. McNulty	X		
Mr. Johnson				Mr. Jefferson	X		
Ms. Dunn		X		Mr. Tanner			
Mr. Collins				Mr. Becerra	X		
Mr. Portman		X		Mrs. Thurman	X		
Mr. English		X					
Mr. Ensign		X					
Mr. Christensen		X					
Mr. Watkins		X					
Mr. Hayworth		X					
Mr. Weller		X					
Mr. Hulshof		X					

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with clause 7(a) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the estimated budget effects of H.R. 2646 as reported.

The bill, as reported, is estimated to have the following effect on the budget:

ESTIMATED BUDGET EFFECTS OF H.R. 2646, THE "EDUCATION SAVINGS ACT FOR PUBLIC AND PRIVATE SCHOOLS," AS APPROVED BY THE COMMITTEE ON WAYS AND MEANS

[Fiscal years 1998–2002, in millions of dollars]

Provision	Effective	1998	1999	2000	2001	2002	1998–2002
1. Extend present-law education IRAs to primary and secondary educational expenses; increase the contribution amount to $2,500; expand to include educational savings for special needs students; allow corporations to contribute to education IRAs	1/1/98	−115	−485	−644	−700	−636	−2,580
2. Clarify deduction for accrued vacation pay	tyea 10/8/97	705	1,111	584	120	126	2,646
Net total		590	626	−60	−580	−510	66

Legend for "Effective" column: tyea=taxable years ending after.

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

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with subdivision (B) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with subdivision (B) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill as reported involve increased tax expenditures for the negative amounts shown in the revenue table in IV.A., above, and a reduction in tax expenditures for the positive amounts shown in the revenue table.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with subdivision (C) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, requiring cost estimate prepared by the Congressional Budget Office, the Committee advises that the Congressional Budget Office has submitted the following statement on this bill.

U.S. Congress,
Congressional Budget Office,
Washington, DC, October 17, 1997.

Hon. Bill Archer,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed H.R. 2646, the Education Savings Act for Public and Private Schools. The JCT estimates that this bill would increase governmental receipts by $590 million in fiscal year 1998, and by $66 million over fiscal years 1998 through 2002. CBO concurs with this estimate.

For a detailed estimate of the H.R. 2646, please refer to the enclosed JCT table.

In accordance with the requirements of Public Law 104–4, the Unfunded Mandates Reform Act of 1995, JCT has determined that H.R. 2646 contains no federal intergovernmental mandates.

In addition, JCT has determined that the amendment contains one federal private sector mandate. The provision to clarify the deduction for accrued vacation pay is estimated to increase tax revenue by $2,646 million over fiscal years 1998 through 2002, which is the estimated amount that the private sector will be required to spend in order to comply with this federal private-sector mandate. The revenue raised from this provision will offset the revenue cost of the education savings provisions of the bill.

FEDERAL PRIVATE SECTOR MANDATES

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	1998–2002
Total Mandate Cost	705	1111	584	120	126	2646

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 establishes pay-as-you-go procedures for legislation affecting receipts or direct spending through 2007. For purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted. Because the bill would affect receipts, pay-as-you-go procedures would apply. These effects are summarized in the table below.

PAY-AS-YOU-GO CONSIDERATIONS

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	1998–2002
Changes in Receipts	590	626	−60	−580	−510	66
Changes in Outlays			Not Applicable			

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

Sincerely,

JUNE E. O'NEILL, *Director.*

Enclosure.

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON TAXATION,
Washington, DC, October 16, 1997.

Mrs. JUNE O'NEILL,
Director, Congressional Budget Office,
Washington, DC.

DEAR MRS. O'NEILL: The staff of the Joint Committee on Taxation has reviewed the provisions of H.R. 2646 ("Education Savings Act for Public and Private Schools") as ordered reported by the House Committee on Ways and Means on October 9, 1997. In accordance with the requirements of Public Law 104–4, the Unfunded Mandates Reform Act of 1995, we have determined that the following provision of the bill contains a Federal private sector mandate:

clarify deduction for accrued vacation pay.

As indicated in the enclosed revenue table, this provision is estimated to increase tax revenue by $2,646 million over fiscal years 1998–2002, which is the estimated amount that the private sector will be required to spend in order to comply with this Federal private sector mandate. The revenue raised from this provision will offset the revenue cost of the education savings provisions of the bill. This provision will not impose a Federal intergovernmental mandate on State, local, or tribal governments, as such governmental entities are generally exempt from Federal income tax.

If you would like to discuss this information further, you may call me or my staff.

Sincerely,

KENNETH J. KIES, *Chief of Staff.*

Enclosure: Revenue table.

ESTIMATED BUDGET EFFECTS OF H.R. 2646, THE ''EDUCATION SAVINGS ACT FOR PUBLIC AND PRIVATE SCHOOLS,'' AS APPROVED BY THE COMMITTEE ON WAYS AND MEANS

[Fiscal years 1998–2002; in millions of dollars]

Provision	Effective	1998	1999	2000	2001	2002	1998–2002
1. Extend present-law education IRAs to primary and secondary educational expenses; increase the contribution amount to $2,500; expand to include educational savings for special needs students; allow corporations to contribute to education IRAs	1/1/98	−115	−485	−644	−700	−636	−2,580
2. Clarify deduction for accrued vacation pay	tyea 10/8/97	705	1,111	584	120	126	2,646
Net total		590	626	−60	−580	−510	66

Legend for ''Effective'' column: tyea=taxable years ending after.

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

Source: Joint Committee on Taxation.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to subdivision (A) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was the result of the Committee's oversight activities concerning the expansion of provisions the education savings provisions to elementary and secondary education expenses and a revenue offset provision relating to the tax treatment of the employer deduction for vacation pay that the Committee concluded that it is appropriate to enact the provisions contained in the bill as reported.

B. Summary of Findings and Recommendations of the Committee on Government Reform and Oversight

With respect to subdivision (D) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the Committee advises that no oversight findings or recommendations have been submitted to this Committee by the Committee on Government Reform and Oversight with respect to the provisions contained in the bill.

C. Constitutional Authority Statement

With respect to clause 2(l)(4) of rule XI of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 7 ("All bills for raising revenue shall originate in the House of Representatives") and Section 8 ("The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts * * * of the United States"), and from the 16th Amendment to the Constitution.

D. INFORMATION RELATING TO UNFUNDED MANDATES

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

The Committee has determined that the provision of the bill relating to the tax treatment of employer deduction for vacation pay will impose a Federal mandate on the private sector in the amount shown in the revenue table in IV.A., above. This revenue is needed to offset the budget cost of the education savings provision. This provision of the bill will not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. APPLICABILITY OF HOUSE RULE XXI5(C)

Rule XXI5(c) of the Rules of the House of Representatives provides, in part, that "No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increase within the meaning of the rule.

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

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman).

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter F—Exempt Organizations

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PART VIII—QUALIFIED STATE TUITION PROGRAMS

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SEC. 530. EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) * * *

(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) EDUCATION INDIVIDUAL RETIREMENT ACCOUNT.—The term "education individual retirement account" means a trust created or organized in the United States exclusively for the purpose of paying the qualified ❲higher❳ education expenses of the designated beneficiary of the trust (and designated as an education individual retirement account at the time created or organized), but only if the written governing instrument creating the trust meets the following requirements:

(A) No contribution will be accepted—

(i) unless it is in cash,

(ii) after the date on which such beneficiary attains age 18, or

(iii) except in the case of rollover contributions, if such contribution would result in aggregate contributions for the taxable year exceeding ❲$500❳ *$2,500*.

* * * * * * *

(E) Upon the death of the designated beneficiary, any balance to the credit of the beneficiary shall be distributed within 30 days after the date of death to the estate of such beneficiary.

The age limitations in the preceding sentence shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary).

❲(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

❲(A) IN GENERAL.—The term "qualified higher education expenses" has the meaning given such term by section 529(e)(3), reduced as provided in section 25A(g)(2).

❲(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account, under a qualified State tuition program (as defined in section 529(b)) for the benefit of the beneficiary of the account.❳

(2) QUALIFIED EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified education expenses" means—

(i) qualified higher education expenses (as defined in section 529(e)(3)), and

(ii) qualified elementary and secondary education expenses (as defined in paragraph (4)).

Such expenses shall be reduced as provided in section 25A(g)(2).

(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account, under a qualified State tuition program (as defined in section 529(b)) for the benefit of the beneficiary of the account.

* * * * * * *

(4) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified elementary and secondary education expenses" means tuition, fees, tutoring,

special needs services, books, supplies, computer equipment (including related software and services) and other equipment, transportation, and supplementary expenses required for the enrollment or attendance of the designated beneficiary of the trust at a public, private, or religious school.

(B) SPECIAL RULE FOR HOMESCHOOLING.—Such term shall include expenses described in subparagraph (A) required for education provided for homeschooling if the requirements of any applicable State or local law are met with respect to such education.

(C) SCHOOL.—The term "school" means any school which provides elementary education or secondary education (through grade 12), as determined under State law.

(c) REDUCTION IN PERMITTED CONTRIBUTIONS BASED ON ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—[The maximum amount which a contributor] *In the case of a contributor who is an individual, the maximum amount the contributor* could otherwise make to an account under this section shall be reduced by an amount which bears the same ratio to such maximum amount as—

(A) * * *

* * * * * * *

(d) TAX TREATMENT OF DISTRIBUTIONS.—

(1) IN GENERAL.—Any distribution shall be includible in the gross income of the distributee in the manner as provided in section 72(b).

(2) DISTRIBUTIONS FOR QUALIFIED [HIGHER] EDUCATION EXPENSES.—

(A) IN GENERAL.—No amount shall be includible in gross income under paragraph (1) if the qualified [higher] education expenses of the designated beneficiary during the taxable year are not less than the aggregate distributions during the taxable year.

(B) DISTRIBUTIONS IN EXCESS OF EXPENSES.—If such aggregate distributions exceed such expenses during the taxable year, the amount otherwise includible in gross income under paragraph (1) shall be reduced by the amount which bears the same ratio to the amount which would be includible in gross income under paragraph (1) (without regard to this subparagraph) as the qualified [higher] education expenses bear to such aggregate distributions.

(C) ELECTION TO WAIVE EXCLUSION.—A taxpayer may elect to waive the application of this paragraph for any taxable year.

* * * * * * *

(4) ADDITIONAL TAX FOR DISTRIBUTIONS NOT USED FOR EDUCATIONAL EXPENSES.—

(A) * * *

* * * * * * *

(C) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Subparagraph (A) shall not apply to the distribution of any contribution made during a taxable year on behalf of a designated beneficiary to the extent that such contribution exceeds ❲$500❳ *$2,500* if—

(i) * * *

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Subtitle D—Miscellaneous Excise Tax

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CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

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SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS, MEDICAL SAVINGS ACCOUNTS, CERTAIN SECTION 403(b) CONTRACTS, AND CERTAIN INDIVIDUAL RETIREMENT ANNUITIES.

(a) * * *

* * * * * * *

(e) EXCESS CONTRIBUTIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—For purposes of this section—

(1) IN GENERAL.—In the case of education individual retirement accounts maintained for the benefit of any 1 beneficiary, the term "excess contributions" means—

(A) the amount by which the amount contributed for the taxable year to such accounts exceeds ❲$500❳ *$2,500*, and

* * * * * * *

VII. DISSENTING VIEWS

We are deeply committed to the goal of expanding educational opportunities in this country. Improving our educational system is the most effective way of ensuring that all of our citizens have an opportunity to participate fully in our economic system. In addition, investments in education are necessary for this country to remain competitive in the world economy.

America's children deserve first-class schools that emphasize academic excellence in the basics. They need well-trained, highly motivated teachers to help them achieve high standards. Public tax dollars should be used to improve public schools—rather than private school "vouchers" at public expense. We believe in a Federal role in education that supports local initiatives for strong neighborhood public schools. Every child should have access to a safe, well-equipped public school.

We oppose the Committee bill because it is inconsistent both with the goal of improving our educational system and with our commitment to attaining a balanced budget. The reasons for our opposition to the bill can be stated quite simply:

(1) The Committee bill is a diversion of scarce resources for the benefit of a small group of wealthy families. These resources should be devoted to the improvement of our public school system, which serves approximately 90 percent of the students in this country.

(2) The Committee bill threatens the goal of a balanced budget because of its large and growing revenue losses.

(3) The Committee bill is not administerable and is so flawed that it invites taxpayer abuses.

Deficit impact

The Committee bill results in large and growing revenue losses that are inconsistent with the recent budget agreement and our goal of a balanced budget. The provision of the bill that expands education savings accounts has a revenue loss which in the first 5 years increases from $115 million per year to over $600 million per year. The bill is funded by a revenue offset that is largely a one-time acceleration of receipts into the first several years of the budget window. For example, the revenue offset is estimated to raise over $1 billion in fiscal year 1999, but only $120 million in fiscal year 2001. As a result, the bill will produce large and growing revenue losses. The Joint Committee on Taxation has estimated that, over a 10-year budget period, the bill would lose approximately $5 billion. This means that the annual revenue loss from the bill would be well over $1 billion in the later part of that 10-year period.

Administerability

From a technical standpoint, the Committee bill is so flawed that it is an embarrassment. The Committee bill is largely based on a Senate Floor amendment that was offered by Senator Coverdell during the consideration of the recently enacted Taxpayer Relief Act of 1997. Like many Senate Floor amendments, Senator Coverdell's amendment appears to have been developed with some haste, largely for political purposes, and with little regard to whether it could actually be administered. That is an accurate characterization of the bill reported by the Committee.

The Committee bill would permit taxpayers to contribute $2,500 per year, per beneficiary to education savings accounts. Income from assets in those accounts would accumulate on a tax-free basis and that income would be exempt from tax if used to pay qualified elementary and secondary education expenses of the designated beneficiary. The bill defines qualified expenses as being tuition, fees, tutoring, special-needs services, books, supplies, computer equipment (including related software and services) and other equipment, transportation, and supplementary expenses required for enrollment or attendance at a public, private, or religious school. The bill provides no hint as to how the Internal Revenue Service is to administer such a provision or what specifically is included in the broad definition of qualified expenses. The technical flaws of the bill were convincingly demonstrated during the Committee markup.

Inquiries by Representatives Rangel and Kleczka during the markup demonstrated the absurd nature of the Committee bill. In response to those inquiries, the Joint Committee staff indicated that payments for tutoring would qualify, even if the tutoring were provided by a parent or brother or sister of the child being tutored and that purchases of cars could qualify as transportation expenses in certain circumstances. These are but two examples of potential abuses that could occur under the careless language of the Committee bill. There are many other personal expenses that taxpayers could characterize as qualified educational expenses for which tax benefits would be provided under the bill. It should be pointed out that this opportunity for abuse would be limited to taxpayers with large amounts of investment assets.

The bill purports to limit the availability of educational savings accounts to taxpayers with annual incomes of less than $95,000 ($160,000 for joint returns). During the markup, Representative Becerra inquired whether a wealthy taxpayer could avoid this limitation through the simple expedient of making a gift to the taxpayer's child, who would then make the contribution to the education savings account. Staff of the Joint Committee responded that the bill would permit such an avoidance technique as long as the child earned less than $95,000. In a classic understatement that created laughter in the audience, the staff described the bill's income limitation as being "porous."

Benefits limited to families with wealth

We recognize that opposing a proposal advertised as promoting school choice is not an easy vote for some Members. Those Members should examine the substance of the Committee bill. If the

Committee bill promotes school choice, it does so only for a small category of wealthy families.

1. The only families who would benefit from the legislation are families with sufficient investment assets to enable them to accumulate income on those assets over a long period of time. Families paying educational expenses out of wage and salary income would receive no benefit under the Committee bill—no matter where those children were schooled.

2. Families with school-age children would receive little benefit. If a family currently has a child in private school, that family would receive the full benefit of the Committee bill only if it could contribute $2,500 to an investment account after paying the current-year costs of the private school. With private-school costs averaging over $3,000 per year, only a few very fortunate families could afford to make such a contribution. In addition, the Committee bill would provide substantial benefits only if the money were allowed to accumulate in the account over a period of years. Therefore, even the few fortunate families able to save for next year's tuition costs would receive little benefit.

3. To receive the maximum benefit, a family would need to have both young children (so that there is time to accumulate income in the account) and substantial investment assets. The following table indicates that few families meet the second requirement. The table is based on data collected by the Federal Reserve Board in its 1995 Survey of Consumer Finances. It shows the median amount of non-retirement investment assets held by families in various income categories. Non-retirement investment assets include checking accounts, savings accounts, and all other financial assets not held in a retirement plan. Not surprisingly, it shows that young families and families with children have relatively small amounts of non-retirement investment assets.

Income category	Percent of families in income category	Median amount of non-retirement investment assets		
		All families	Families headed by individual under 35 years of age	Families with children under 18 years of age
Less than $10,000	16	$440	$150	$10
$10,000 to 20,000	18	1,750	500	400
$20,000 to 30,000	15	3,000	1,230	1,200
$30,000 to 40,000	15	5,400	2,500	2,700
$40,000 to 50,000	10	7,900	3,400	4,950
$50,000 to 75,000	14	15,800	8,420	10,800
$75,000 to 100,000	6	27,300	23,200	22,300
$100,000 to 200,000	5	58,000	43,000	49,200
Over $200,000	1	255,000	270,000	183,100

We believe that the table above amply demonstrates which families will benefit from the Committee bill. The amount of non-retirement investment assets is a very good measure of a family's ability to take advantage of the Committee bill. Without those assets, a family would have to save out of current-year wages $2,500 per year, per child to take full advantage. We all know how few families can afford to do this.

If the Committee bill had provided a nonrefundable credit available to all taxpayers with children for qualified education expenses and that credit were designed to have the same revenue loss as the Committee bill, the Joint Committee indicated that the amount of that credit would be $15 per child per year. This is an indication of the average benefit per child received under the Committee bill. The $15 figure is merely the amount derived by averaging the large benefits received by relatively few taxpayers with the non-existent or nominal benefits received by the overwhelming number of taxpayers. Representative McDermott offered an amendment that demonstrated this inequitable feature of the Committee bill.

Democratic alternative

We believe that to improve our public school system we must encourage both greater private-sector involvement and provide additional resources for our public school system to meet pressing needs of school construction and repair, equipment purchase, course development, and teacher training. We believe the amendment offered by Representative Rangel in the Committee, to expand the education zone bond provisions of the recently enacted Taxpayer Relief Act, would accomplish both goals.

Section 226 of the Taxpayer Relief Act of 1997 provides an interest-free source of capital for public schools that enter into partnerships with the private sector to improve the academic curriculum. Those interest-free funds can be used for school rehabilitation or repair, purchases of equipment, development of course materials, and teacher training expenses.

The program established under section 226 is targeted to the public schools with the greatest needs. To be eligible to participate in the program, a school must be located in a distressed area eligible for special tax incentives under the empowerment zone and enterprise community provisions of the Internal Revenue Code *or* at least 35 percent of the students in the school must be eligible for free or reduced-cost lunches under the Federal school lunch program. More than half of public schools meet those eligibility requirements. In addition, a school not meeting those requirements could create a special program within the school for disadvantaged students and receive benefits for that program.

The program provides interest-free capital by permitting the local government to borrow money from financial institutions without interest costs. Under the provision, a tax credit is provided to the financial institution equal to the interest that would otherwise be required to be paid. The local government is required to repay the principal amount of the borrowing, but it will receive an interest rate subsidy with a value equal to 50 percent of the principal amount.

Under current law, there is an overall limitation on the amount that can be borrowed under the program—$400 million in each of the next two calendar years. The amendment offered by Representative Rangel would increase that limitation to $4 billion for each of the next two calendar years. In addition, school construction would qualify under the program.

No benefits would be provided under Representative Rangel's amendment to any school unless that school enters into a partnership with the private sector to insure that its academic program is relevant in today's ever-changing economy.

We would like to emphasize that all of the benefits from Representative Rangel's amendment would flow directly to the public school system. The tax credit provided under his amendment to financial institutions would merely compensate them for the interest that they otherwise would have received from the public school system.

The other point that we would like to emphasize is that Representative Rangel's amendment would not be inconsistent with our goal of a balanced budget. His amendment would have a positive impact on the deficit both during a 5-year and a 10-year budget window.

Ninety percent of the students of this country attend public schools, and therefore, we should focus our limited resources on the public school system.

CHARLES B. RANGEL.
XAVIER BECERRA.
RICHARD E. NEAL.
MICHAEL R. MCNULTY.
JOHN LEWIS.
PETE STARK.
BEN CARDIN.
WM. J. JEFFERSON.
BARBARA B. KENNELLY.
KAREN L. THURMAN.
ROBERT T. MATSUI.
JIM MCDERMOTT.
WILLIAM J. COYNE.
SANDER LEVIN.