

**DESCRIPTION OF MODIFICATIONS
TO CHAIRMAN'S MARK
OF AN AMENDMENT TO S. 1133
("PARENT AND STUDENT SAVINGS ACCOUNT PLUS ACT")**

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

on February 10, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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JCX-7-98

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on February 10, 1998, on a proposed Chairman's amendment ("Chairman's mark") to S. 1133 ("Parent and Student Savings Account Plus Act"). A description of the proposed Chairman's amendment in the nature of a substitute is contained in *Description of Chairman's Mark of an Amendment to S. 1133 ("Parent and Student Savings Account Plus Act")* (JCX-5-98), February 6, 1998, prepared by the staff of the Joint Committee on Taxation.

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of modifications to the Chairman's mark. It contains a description of a provision relating to the treatment of National Health Corps Scholarships; a clarification of the treatment of after-school programs for purposes of education IRAs; and certain tax incentives for the rehabilitation and construction of public schools.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of Modifications to Chairman's Mark of an Amendment to S. 1133 ("Parent and Student Savings Account Plus Act")* (JCX-7-98), February 10, 1998.

1. Qualified zone academy bonds; qualified high-growth school assistance bonds

Present Law

Tax-exempt bonds

Interest on State and local governmental bonds generally is excluded from gross income for Federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units, including the financing of public schools.

Zone academy bonds

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 by the Treasury Department) multiplied by the face amount of the bond. 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 is includible in gross income (as if it were an interest payment on the bond). The credit may be claimed against regular income tax and AMT liability.

The Treasury Department will set the credit rate each month at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bond issued in a given month also is determined by the Treasury Department so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Such present value will be determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

“Qualified zone academy bonds” are defined as any bond issued by a State or local government, provided that (1) 95 percent of the proceeds are 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 enterprise community², 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.

A total of \$400 million of "qualified zone academy bonds" may be issued in each of 1998 and 1999. The \$800 million aggregate bond cap will be allocated to the States according to their respective populations of individuals below the poverty line. Each State, in turn, will allocate the credit to qualified zone academies within such State. A State may carry over any unused allocation into subsequent years.

Description of Chairman's Mark

Qualified zone academy bonds

The proposal would increase the amount of tax credits available to holders of qualified zone academy bonds. The enhanced credit would reduce the outstanding principal amount of the bond by 15 percent per year and would be available over a four-year period. The maximum amount by which the principal could be reduced would be 60 percent.

Qualified high-growth school assistance bonds

The proposal would permit State and local governments to issue a total of \$600 million of "qualified high-growth school assistance bonds" in 1999 and \$400 million of such bonds in 2000. Qualified high-growth school assistance bonds would be used to fund the construction or rehabilitation of public schools that are located in school districts with rapidly growing student populations.

As with qualified zone academy bonds, certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold "qualified high-growth school assistance bonds" would be entitled to a nonrefundable tax credit in an amount equal to a credit rate (set by the Treasury Department) multiplied by the face amount of the bond. The credit rate would apply to all such bonds issued in each month. A

² Pursuant to the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), the Secretaries of the Department of Housing and Urban Development (HUD) and the Department of Agriculture designated a total of nine empowerment zones and 95 enterprise communities on December 21, 1994. Designated empowerment zones and enterprise communities were required to satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations. The Code provides special tax incentives for certain business activities conducted in empowerment zones and enterprise communities. In addition, the Taxpayer Relief Act of 1997 provides for the designation of 22 additional empowerment zones and designates the District of Columbia as an empowerment zone.

taxpayer holding a qualified high-growth school assistance bond would be entitled to a credit for each year the taxpayer holds the bond. The credit would be includible in gross income (as if it were an interest payment on the bond), but may be claimed against regular income tax and AMT liability.

The Treasury Department would set the credit rate each month at a rate estimated to allow issuance of qualified high-growth school assistance bonds without discount and without interest cost to the issuer. The maximum term of the bond issued in a given month also would be determined by the Treasury Department so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Such present value would be determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

“Qualified high-growth school assistance bonds” would be defined as any bond issued by a State or local government, provided that 95 percent of the proceeds are used for the purpose of renovating or constructing qualified public school facilities. A school would be a “qualified public school facility” if the school is located in a “high-growth district.” A “high-growth district” generally would be defined as a school district with enrollment of at least 5,000 students in 1995 that experienced an increase in student enrollment of 20 percent or more during the period 1990-1995. In certain circumstances, States would be permitted to develop alternative criteria for defining a high-growth district.

The proposal would provide an enhanced credit to holders of certain qualified high-growth school assistance bonds used to finance qualified public school facilities at which 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. The enhanced credit would reduce the outstanding principal amount of the bond by 15 percent per year and would be available over a four-year period. The maximum amount by which the principal could be reduced would be 60 percent. The enhanced credit would be available on not more than \$300 million of qualified high-growth school assistance bonds issued in 1999 and not more than \$200 million of qualified high-growth school assistance bonds issued in 2000.

A total of \$600 million of “qualified high-growth school assistance bonds” could be issued in 1999 and \$400 million in 2000. The \$1 billion aggregate bond cap would be allocated \$5 million to each State and the remainder would be allocated among the States that have high-growth districts. Each State, in turn, would allocate the credit to qualified public schools within such State. A State could carry over any unused allocation into subsequent years.

Effective Date

The proposals would be effective on the date of enactment.

2. Clarification of treatment of after-school program K-12 expenses for purposes of education IRAs.

Present Law

Amounts distributed from education IRAs (as described in sec. 530) are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of the designated beneficiary during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed under sec. 25A with respect to the beneficiary for the same taxable year.

Description of Chairman's Mark

For purposes of the Chairman's mark--which, with respect to contributions made during the period 1999 through 2002 (and earnings attributable thereto), would allow tax-free distributions from education IRAs to cover qualified elementary and secondary education expenses--the proposal would clarify that such expenses would include expenses incurred in connection with after-school programs administered for students enrolled in the grades K through 12.

Effective Date

The proposal would be effective for expenses paid in taxable years beginning after December 31, 1998.

3. National Health Corps Scholarship exclusion

Present Law

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

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

Description of Chairman's Mark

S. 1286 (introduced by Senator Jeffords on October 9, 1997) would provide that amounts received by an individual under the National Health Corps Scholarship Program--administered under section 338A(g)(1)(A) of the Public Health Service Act--would be eligible for tax-free treatment as a qualified scholarship under section 117, without regard to the fact that the recipient of the scholarship is obligated to later provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. The tax-free treatment would not apply to amounts received by students to cover living regular living expenses, such as room and board.

Effective Date

The proposal would apply to amounts received in taxable years beginning after December 31, 1993.