



Capitol Update 06-2

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FEDERAL ACTIVITIES

Securities Issues

SEC Broker-Dealer Rule Goes into Effect. The Broker-Dealer Rule went into effect on January 31st despite a last minute effort by the Securities Industry Association (SIA) – opposed by FPA – to obtain a second postponement of the compliance deadline. SIA petitioned the SEC claiming that brokerage firms needed until March 31st to adjust their compliance programs in light of SEC staff interpretive guidance issues in December. “We note that the interpretive guidance issued by SEC staff in December was requested by SIA and that the guidance – which FPA believes was profoundly flawed – had the effect of further expanding the broker-dealer exemption, thereby easing compliance burdens for SIA’s member firms,” wrote FPA. “It strikes us as inappropriate that SIA, having obtained this interpretive guidance, should now seek to use it as a bootstrap in obtaining yet another extension of the compliance deadline.” FPA’s letter may be viewed at http://www.fpanet.org/member/govt_relation/new/index.cfm.

SEC Appoints Acting Director of Investment Management Division. SEC Chairman Cox announced Susan Ferris Wyderko as the Acting Director of the Commission’s Division of Investment Management, which oversees mutual funds and investment advisers. Ms. Wyderko, who has been with the SEC for over 20 years, has served as the Director of the Office of Investor Education and Assistance since March 2000. For the actual SEC press release, go to <http://www.sec.gov/news/press/2006-8.htm>.

Tax Issues

FPA Publishes 2006 Tax Update. The 2006 tax update, including 2006 numbers for IRAs, qualified plans, and estate tax planning, is located on the FPA website in the Government Relations section. For the latest tax numbers, go to http://www.fpanet.org/member/govt_relation/index.cfm and click on the 2006 Tax Update.

State of the Union Proposals. Top priorities for President Bush in his State of the Union message included extending tax cuts, increasing HSA contribution limits, and ensuring health insurance portability. The White House proposal for portability of health insurance would allow individuals to purchase a nationally regulated health insurance product across state lines and allow for small businesses to pool together across state lines in association health plans to purchase coverage free from conflicting state

insurance mandates. In addition, President Bush proposed larger contributions to HSAs, by letting HSA holders make annual contributions to cover all of their out-of-pocket costs under their HSA policies, not just their deductible as allowed under current law. This also included making premiums tax deductible for high-deductible health insurance plans linked with HSAs purchased in the individual market and a health insurance tax credit. President Bush again called for Social security reform and proposed creation of partisan commission. Many lawmakers had dropped Social Security from the agenda this election year, and major reform is not expected until the new Congress. For a description of these issues, go to <http://www.whitehouse.gov/infocus/index.html>.

FPA Opposes Increase in Fees for IRS Private Letter Rulings. FPA has written the IRS expressing its opposition to the increase in fees for private letter rulings. Effective Feb. 1, 2006, the IRS has significantly increased the fee for a private letter ruling from \$625 to \$2,500 for taxpayers earning \$250,000 to \$1 million. Also, opinion letters on prototype IRAs, SEPs, SIMPLE IRAs and Roth IRAs will nearly double. These fees, which were previously \$125 to \$2,570, will now range from \$200 to \$4,500. IRA rollover activities, which previously cost as little as \$95, now have fees ranging between \$500 and \$3,000. Fees for the IRS to consider the granting of a waiver to correct a mistake in a retirement rollover have increased from \$95 up to \$3,000. Small businesses that set up a SEP account will see an increase in fees from \$625 to up to \$9,000, not including legal fees. FPA's letter opposing the increase can be found at: http://www.fpanet.org/member/govt_relation/comments/index.cfm.

Federal Borrowing Rises to Record Level. The Treasury expects to borrow \$188 billion in first quarter of 2006, substantially more than it anticipated three months ago. The total will surpass the old mark of \$146 billion set in the first quarter of 2004, when the federal budget deficit hit an all-time high of \$413 billion. The budget deficit will hit \$337 billion this year according to the Congressional Budget Office, up from the fiscal 2005 deficit of \$318.62 billion. The Treasury Department has also announced that it will bring back the 30-year Treasury bond with the first auction of the new bonds taking place February 9th.

U.S. Savings Rate at Lowest Level since 1933. Americans' personal savings rate has dropped to negative numbers for the first time since the Great Depression. The Commerce Department reported Monday that the savings rate fell into negative territory at minus 0.5 percent, meaning that Americans not only spent all of their after-tax income last year but had to dip into previous savings or increase borrowing. The savings rate has been negative for an entire year only twice before in 1932 and 1933. With employment growth strong now, analysts said that different factors are at play. Americans feel they can spend more, given that the value of their homes, the biggest asset for most families, has been rising sharply in recent years. But analysts cautioned that this behavior was risky at a time when 78 million Americans are on the verge of retirement.

New Chairman and Increased Rates at Federal Reserve Board. Alan Greenspan ended his tenure at the central bank on Jan. 31st, and the Federal Reserve has increased the target federal funds rate one-quarter point to 4.5 percent. Ben Bernanke was confirmed by a voice vote in the Senate and was sworn-in as Fed chairman on Feb. 1st. President

Bush has nominated Edward P. Lazear, a Stanford University labor economist, to be the next chairman of the president's Council of Economic Advisers, replacing Chairman Bernanke.

Tax Reconciliation. Conflicting House and Senate versions of the tax reconciliation bill are expected to go into conference in early February. The House version (H.R. 4297) included a two year extension on the capital gains and dividend rates. The Senate did not include capital gains and dividends rate extensions in its reconciliation bill (S. 2020) because of political concerns about cutting low-income programs while at the same time extending tax breaks for investors that are due to expire in 2009. It is expected that capital gains and dividend rate extension will survive in conference, but it remains unclear whether the extension will be for one or two years.

Lawmakers have also been struggling with how to deal with the AMT. The Senate included a one-year patch in its tax reconciliation bill (S. 2020), while the House passed a separate bill (H.R. 4096) to fix AMT. The reduction in marginal tax rates in recent years has increased the AMT's importance as a revenue source and it is likely that Congress will adopt a one-year patch for the time being. Both the House and the Senate will begin the process of naming conferees this week. For actual wording of the bills, go to <http://thomas.loc.gov/> and type S. 2020 or H.R. 4297 and 4096 in the search engine.

Budget Reconciliation Bill. The House and the Senate have both approved the Deficit Reduction Act of 2005 (S. 1932), which reduces the amount of spending on federal entitlement programs by almost \$39 billion over five years. By narrow votes in both chambers, the act now goes to the President's desk for his signature. The primary cuts come from Medicare, Medicaid, student loan and food stamp programs, including Medicaid and Medicare cuts which will reach nearly \$11 billion over five years. The legislation also makes sweeping changes to FDIC insurance. Insurance levels will now be tied to inflation and the insurance for retirement accounts will increase to \$250,000. In light of this legislation, a merger of the Bank Insurance Fund and the Savings Association Insurance Fund is expected. For the wording of the conference report, go to <http://thomas.loc.gov/>, enter S. 1932 in the search engine, and then select the Deficit Reduction Act of 2005 (Engrossed Amendment as Agreed to by Senate).

Changes in Medicaid Look-Back Provisions. The Deficit Reduction Act also revised the look-back provisions for Medicaid coverage so that those with substantial assets will have a more difficult time qualifying for long-term Medicaid coverage in nursing homes. The legislation also includes increased penalties on individuals who transfer assets for less than fair market value in order to qualify for nursing home care, restricted eligibility for people with substantial home equity, allowance for states to impose higher cost-sharing requirements and/or premiums on certain enrollees, and allowing states to restrict benefits for certain enrollees.

Deficit Reduction Act Affects Treatment of 529 Plans. The recently passed Deficit Reduction Act changes the characterization of 529 plans in regard to a student's eligibility to receive financial aid. One provision disallows a 529 account from being considered a student asset in the formula that determines expected family contribution

(EFC). In the past when calculating student resources, a prepaid plan was treated as a "resource", thereby reducing need-based financial aid dollar for dollar, and money in custodial UGMA/UTMA accounts were assessed as student assets at the flat rate of 35 percent. In the new law, prepaid plans will now also be treated as a parent's asset, where only 5.64 percent of the assets in the account are counted for reducing a student's aid eligibility. Under the proposed changes, a family will be able to improve their aid prospects simply by moving existing UGMA/UTMA assets into a custodial 529 account. A caveat remains in that prepaid plans are typically intended for a state public institution, and families may be penalized if the student attends a college in another state or at a private school. Because of the new change, it is predicted that the number of prepaid plans will more than double in the next three years. For specific 529 information, go to <http://www.savingforcollege.com/>.

Investment Advice in Federal Pension Legislation. Congress wants to make it easier for employees to obtain advice on their investment choices in 401(k) plans. The House version (H.R. 2830) of the investment advice provision in the pension bill would allow mutual fund companies to offer advice so long as they provide disclosure about fees and conflicts of interest. The Senate version (S. 1783) of the provision continues a ban on direct advice from fund firms, but would encourage companies to hire RIAs or broker-dealers to advise employees about the plan. The House and Senate soon will meet in a conference to reconcile the two pension bills, since April 15th is the deadline for pension benefit payments. Once conferees are named, FPA will write them expressing its general support of the Senate investment advice provision coupled with the disclosure in the House bill. For the wording of the two bills, go to <http://thomas.loc.gov/> and type S. 1783 or H.R. 2830 in the search engine.

DOL Issues Advisory Opinion on ERISA Fiduciary Advice. The Office of Regulations and Interpretations at the Department of Labor has issued an advisory opinion responding to questions about fiduciaries within a plan in connection with ERISA Section 3(21)(A). The letter clarifies that an individual who advises a plan participant on how to invest or manage assets in exchange for a fee is a fiduciary with respect to the plan. According to the letter, a person that directs the investments within a plan exercises authority over the management and disposition of plan assets, and thereby, is considered to be a fiduciary, even if the advisor is chosen by the plan participant only and has no other connection to the plan. This definition of fiduciary also applies to investment advice given to a participant or individual in an individual account plan that allows for investment allocation by participants or beneficiaries. There are several components that would trigger a fiduciary responsibility within a plan offering investment advice. For the Advisory Opinion, go to <http://www.dol.gov/ebsa/regs/aos/ao2005-23a.html>.

AMT Tool on IRS Website. The IRS unveiled a new online tool to help individual taxpayers determine whether they are potentially subject to the alternative minimum tax. The new "AMT Assistant" Web feature helps taxpayers determine whether they may be subject to the tax by automating an AMT worksheet from Form 1040 instructions. Most taxpayers should be able to enter their information and get an answer in five to 10

minutes using the new application. The information taxpayers provide for the AMT Assistant is anonymous and will be used only for purposes of determining AMT liability. To locate the tool, go to <http://www.irs.gov/businesses/small/article/0,,id=150703,00.html> and click on the AMT Assistant. Taxpayers must complete a draft 1040 through line 44 and have that form available to use the AMT Assistant.

Summary of Final Rules on Roth 401(k) Contributions. As of January 1, 2006, an employer may permit elective contributions under a qualified cash or deferred arrangement to a Roth 401(k) or Roth 403(b) account. New Roth contributions allow employees to designate all or a portion of their section 401(k) employee deferrals as Roth contributions, which would receive treatment much like a Roth IRA contribution. FPA's summary of the new rules is posted on the website at http://www.fpanet.org/member/govt_relation/index.cfm under the compliance section.

IRS Roth 401(k) and 403(b) Distribution Rules. The IRS has proposed rules that clarify the taxation of distributions from Roth 401(k) and 403(b) accounts. Generally, the proposed rules holds that Roth 401(k)s follow the qualified plan rules for distributions and rollovers, making a qualified distribution from a designated Roth account excluded from gross income. Distributions from these accounts must follow the rules for a qualified Roth distribution, and the Roth distributions can only be rolled over to other Roth plans or IRAs. According to the proposed rules, nonqualified distributions would be taxed and the designated Roth account would be treated as a separate contract. The nonqualified distributions are taxed on income earned on the account, but not on the investment in the account, or basis, where the taxable earnings on the basis are first distributed. The reporting and recordkeeping requirements in the proposed regulations do not become effective until the 2007 tax year, thereby giving sufficient time for compliance. The rules are found in the Federal Register at <http://frwebgate4.access.gpo.gov/cgi-bin/waisgate.cgi?WAISdocID=9194934800+0+0+0&WAISaction=retrieve>.

IRS Issues New Publications for Hurricane Tax Relief Changes. The IRS has issued a Publication 4492, explaining changes to the tax law and relief provisions available to those affected by hurricanes Katrina, Rita, and Wilma. It lists the disaster areas for each hurricane and explains which areas are eligible for administrative relief from IRS and which areas receive special tax breaks under recently enacted provisions of the tax law. The IRS has also issued a fact sheet (FS-2006-12) addresses provisions of the Gulf Opportunity Zone Act of 2005 and KETRA, and will be available in February. The recent legislation necessitates a change to Line 11 of the 2005 Form 4684, Casualties and Thefts, and its instructions. All of the above changes and publications can be found at: <http://www.irs.gov>.

IRS Changes Form 1041 for Estates and Trusts. The IRS has changed the 2005 instructions for Form 1041. Now, the first sentence under Item G on page 42 reads: "If the estate or trust has invested in a registration-required tax shelter, you must check this box and furnish a copy of its Form 8271, Investor Reporting of Tax Shelter Registration

Number, to the beneficiary(ies)." The corrected instructions are available at <http://www.irs.ustreas.gov/pub/irs-pdf/i1041.pdf>.

STATE ACTIVITIES

PA FPA Chapters Act on Senate Bill 854. FPA chapters in Pennsylvania quickly mobilized a grassroots effort to oppose the "management consulting service" provision in Senate Bill 854 that would impose a 6% sale and use tax to include financial planning services. The bill passed the House on Dec. 20, 2005 on a 103-92 vote, but because of the overwhelming opposition to this provision, the bill, currently in the Senate, is expected to either delete this provision or replace it with language that does not include the sales tax on financial planning services. Our congratulation goes to the Pennsylvania FPA chapters for quick and united efforts on the opposition to this provision. For the actual bill text, go to

<http://www.legis.state.pa.us/WU01/LI/BI/BT/2005/0/SB0854P1429.HTM>.

Massachusetts Lawmakers Rescind Retroactive 2002 Tax Bills. House and Senate leaders in Massachusetts have abandoned plans to retroactively charge 48,000 taxpayers for capital gains incurred nearly four years ago and also ordered thousands of refunds to investors after they received thousands of angry emails and phone calls. Forty-eight thousand taxpayers, who sold assets in the first four months of 2002, received bills to pay taxes for those transactions at a higher rate than lawmakers enacted that year. Lawmakers now say those bills can now be ignored, and taxpayers who paid capital gains taxes at the higher rate in 2002 can apply for a refund. For the technical information release issued by the MA Department of Revenue, go to http://www.dor.state.ma.us/rul_reg/tir/tir_05_20.htm.

Indiana House Revamps Property Tax. The Indiana House overwhelmingly approved an emergency property tax relief bill (H.B. 1001) that would give homeowners an average 7 percent break their 2006 tax bills and abolish property taxes in 2009. The bill includes a one-time tax credit to help mitigate an expected property tax increase this year. Under the bill, if residential tax payments are reduced because of the limit on tax rates for residential property then state expenditures for the property tax replacement credit and homestead credit would also be increased or reduced subject to appropriation beginning in 2007. Also beginning in 2007, if the provision to allow the "banking" of unused maximum levies increases or reduces levy amounts in a year then state expenditures for the property tax replacement credit and homestead credit would also be increased or reduced subject to appropriation. Text of H.B. 1001 is available at <http://www.in.gov/legislative>.

Wyoming Considers Cancelling 529 College Savings Plan. Wyoming may become the first state to do away with its 529 college savings plan. The state legislature will decide as early as February whether to shut down the plan, which began in 2000. Wyoming's plan is one of the smallest in the country with less than 1,500 accounts and \$20 million in assets, and the in-state population won't support a plan on its own. It is predicted that if Wyoming's plan is dissolved, other small states may follow suit.

Illinois Simplifies Household Employers in Remitting Withholdings. Illinois Governor Blagojevich simplified household tax obligations by signing H.B. 2133, known as Public Act 94-723, which permits household employers to pay unemployment insurance and Illinois incomes taxes annually rather than quarterly. This legislation is designed to help taxpayers fulfill their household employee tax obligations who employ nannies, housekeepers, and other domestic workers. The Illinois Department of Revenue also has established a website where household employers can make these payments online. The new web address is <http://www.household.illinois.gov>.

FPA's Washington D.C. Office Relocates. FPA's Washington office now includes the Government Relations staff, the newly formed Public Affairs department and the Pro Bono staff. Pro Bono personnel had previously been based in New York City. The new Washington, D.C. office is located in the heart of downtown at the corner of 16th and K Streets, NW. The new contact information is: 1600 K Street, NW, Suite 201, Washington, DC 20006, and the new direct dial main phone number is 202.449.6340.

FPA POLITICAL ACTION COMMITTEE

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