

109TH CONGRESS, 2ND SESSION

SENATE
 CHARLES E. GRASSLEY, IOWA,
 CHAIRMAN
 CHRIS G. HATCH, UTAH
 DON NICKLES, OKLAHOMA
 MAX BAUCUS, MONTANA
 JOHN D. ROCKEFELLER IV, WEST VIRGINIA

HOUSE
 WILLIAM M. THOMAS, CALIFORNIA,
 VICE CHAIRMAN
 PHILIP M. CRANE, ILLINOIS
 L. GRAY SHAW, JR., FLORIDA
 CHARLES B. RANGEL, NEW YORK
 ROYNEY PETE STARK, CALIFORNIA

GEORGE K. YIN
 CHIEF OF STAFF
 BERNARD A. SCHMITT
 DEPUTY CHIEF OF STAFF
 THOMAS A. BARTHOLD
 DEPUTY CHIEF OF STAFF

Congress of the United States

JOINT COMMITTEE ON TAXATION
 1015 LONGWORTH HOUSE OFFICE BUILDING
 WASHINGTON, DC 20515-6453
 (202) 225-3621
<http://www.house.gov/jct>

SEP 10 2004

Honorable Lee Terry
 U.S. House of Representatives
 1524 Longworth House Office Building
 Washington, DC 20515

Dear Mr. Terry:

This letter is in response to your request dated May 20, 2004, for a revenue estimate of a revised version of your Long-Term Care bill. In general, the proposal would provide an exclusion from income for certain retirement plan distributions that are used to pay for long-term care insurance premiums.

Under present law, distributions from a tax-qualified retirement plan, tax-sheltered annuity, or traditional individual retirement plan ("IRA") are generally includible in income, except to the extent that the distribution is attributable to after-tax or nondeductible contributions (i.e., basis). Distributions from a Roth IRA are excludable from income if certain requirements are satisfied. An additional 10-percent early withdrawal tax applies to the taxable portion of a distribution if the distribution is made before age 59 ½, unless the distribution qualifies for an exception under section 72(t)(2) of the Internal Revenue Code (the "Code"). In-service distributions from a qualified cash or deferred arrangement (a "section 401(k) plan") or a tax-sheltered annuity (a "section 403(b) annuity") prior to attaining age 59 ½ are only permitted under certain circumstances, such as death or disability of the participant and financial hardship. In addition, any insurance coverage (such as long-term care) provided under a qualified plan must be incidental to the provision of retirement benefits ("incidental benefit rule").

Under the proposal, distributions of amounts attributable to elective deferrals under a section 401(k) plan or section 403(b) annuity and distributions from an IRA would be excludable from income (and thereby not subject to the 10-percent early withdrawal tax) up to the amount of long-term care insurance premiums paid during the taxable year for insurance covering the individual or the individual's spouse. Any amount excluded under the proposal could not be taken into account in determining the itemized deduction for medical expenses. The proposal also allows section 401(k) plans and section 403(b) annuities to make distributions to pay for long-term care insurance premiums without losing tax-favored status, thus providing an exception from the in-service distribution rules and the incidental benefit rule for such distributions.

We expect several effects from the proposal. These effects include, among others, an increase in the purchase of long-term care insurance and an increase in distributions from 401(k) plans, 403(b) annuities, and IRAs. However, the behavioral response with the largest impact on

Congress of the United States
 JOINT COMMITTEE ON TAXATION
 Washington, DC 20515-6453

Honorable Lee Terry
 U.S. House of Representatives

Page 2

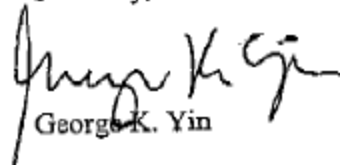
the revenue estimate is individuals who are active participants in a section 401(k) plan, a section 403(b) annuity or deductible IRA, but are not at the contribution limit (\$13,000 in 2004 for elective deferrals to 401(k) plans and 403(b) annuities, and \$3,000 for deductible IRAs), who, as a result of the proposal, will make additional contributions to such a plan and withdraw an equivalent amount to pay for long-term care insurance. This technique of "running" the payment of long-term care insurance premiums through a plan that allows for pre-tax or deductible contributions effectively provides these individuals with an above-the-line deduction for long-term care insurance premiums.

The proposal would be effective for distributions made after the date of enactment, which we have assumed to be October 31, 2004. Estimated changes in Federal fiscal year budget receipts are as follows:

Fiscal Years [Billions of Dollars]											
<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2005-09</u>	<u>2005-14</u>
-0.2	-1.3	-1.4	-1.6	-1.8	-2.1	-2.3	-2.8	-3.1	-3.4	-6.3	-20.0

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,


 George K. Yin