

EDUCATION SAVINGS AND SCHOOL EXCELLENCE ACT OF
1998

JUNE 15, 1998. Ordered to be printed

Mr. ARCHER, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 2646]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to 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 met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Education Savings and School Excellence Act of 1998”.

TITLE I—TAX INCENTIVES FOR EDUCATION

SEC. 100. AMENDMENT TO 1986 CODE.

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

Subtitle A—Tax Incentives For Education

SEC. 101. MODIFICATIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

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

(1) IN GENERAL.—Section 530(b)(2) (defining qualified higher education expenses) 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) (relating to definitions and special rules) 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—

“(i) expenses for tuition, fees, academic tutoring, special needs services, books, supplies, computer equipment (including related software and services), and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary of the trust as an elementary or secondary school student at a public, private, or religious school, or

“(ii) expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance.

“(B) SPECIAL RULE FOR HOMESCHOOLING.—Such term shall include expenses described in subparagraph (A)(i) in connection with education provided by 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 (kindergarten through grade 12), as determined under State law.”.

(3) SPECIAL RULES FOR APPLYING EXCLUSION TO ELEMENTARY AND SECONDARY EXPENSES.—Section 530(d)(2) (relating to

distributions for qualified higher education expenses), as amended by subsection (e), is amended by adding at the end the following new subparagraph:

“(E) SPECIAL RULES FOR ELEMENTARY AND SECONDARY EXPENSES.—

“(i) IN GENERAL.—The aggregate amount of qualified elementary and secondary education expenses taken into account for purposes of this paragraph with respect to any education individual retirement account for all taxable years shall not exceed the sum of the aggregate contributions to such account for taxable years beginning after December 31, 1998, and before January 1, 2003, and earnings on such contributions.

“(ii) SPECIAL OPERATING RULES.—For purposes of clause (i)—

“(I) the trustee of an education individual retirement account shall keep separate accounts with respect to contributions and earnings described in clause (i), and

“(II) if there are distributions in excess of qualified elementary and secondary education expenses for any taxable year, such excess distributions shall be allocated first to contributions and earnings not described in clause (i).”.

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

(b) MAXIMUM ANNUAL CONTRIBUTIONS.—

(1) IN GENERAL.—Section 530(b)(1)(A)(iii) (defining education individual retirement account) is amended by striking “\$500” and inserting “the contribution limit for such taxable year”.

(2) CONTRIBUTION LIMIT.—Section 530(b) (relating to definitions and special rules), as amended by subsection (a)(2), is amended by adding at the end the following new paragraph:

“(5) CONTRIBUTION LIMIT.—The term ‘contribution limit’ means \$500 (\$2,000 in the case of any taxable year beginning after December 31, 1998, and ending before January 1, 2003).”.

(3) CONFORMING AMENDMENT.—Section 4973(e)(1)(A) is amended by striking “\$500” and inserting “the contribution limit (as defined in section 530(b)(5)) for such taxable year”.

(c) WAIVER OF AGE LIMITATIONS FOR CHILDREN WITH SPECIAL NEEDS.—Section 530(b)(1) (defining education individual retirement account) 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.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) 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) **TECHNICAL CORRECTIONS.**—

(1) Section 530(b)(1) is amended by inserting “an individual who is” before “the designated beneficiary” in the material preceding subparagraph (A).

(2)(A) Section 530(b)(1)(E) is amended to read as follows:

“(E) Except as provided in subsection (d)(7), any balance to the credit of the designated beneficiary on the date on which the beneficiary attains age 30 shall be distributed within 30 days after such date to the beneficiary or, if the beneficiary dies before attaining age 30, shall be distributed within 30 days after the date of death of such beneficiary.”

(B) Section 530(d)(7) is amended by inserting at the end the following new sentence: “In applying the preceding sentence, members of the family of the designated beneficiary shall be treated in the same manner as the spouse under such paragraph (8).”

(C) Section 530(d) is amended by adding at the end the following new paragraph:

“(8) **DEEMED DISTRIBUTION ON REQUIRED DISTRIBUTION DATE.**—In any case in which a distribution is required under subsection (b)(1)(E), any balance to the credit of a designated beneficiary as of the close of the 30-day period referred to in such subsection for making such distribution shall be deemed distributed at the close of such period.”

(3)(A) Section 530(d)(1) is amended by striking “section 72(b)” and inserting “section 72”.

(B) Section 72(e) is amended by inserting after paragraph (8) the following new paragraph:

“(9) **EXTENSION OF PARAGRAPH (2)(B) TO QUALIFIED STATE TUITION PROGRAMS AND EDUCATIONAL INDIVIDUAL RETIREMENT ACCOUNTS.**—Notwithstanding any other provision of this subsection, paragraph (2)(B) shall apply to amounts received under a qualified State tuition program (as defined in section 529(b)) or under an education individual retirement account (as defined in section 530(b)). The rule of paragraph (8)(B) shall apply for purposes of this paragraph.”

(4) Section 135(d)(2) is amended to read as follows:

“(2) **COORDINATION WITH OTHER HIGHER EDUCATION BENEFITS.**—The amount of the qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by—

“(A) the amount of such expenses which are taken into account in determining the credit allowable to the taxpayer or any other person under section 25A with respect to such expenses, and

“(B) the amount of such expenses which are taken into account in determining the exclusion under section 530(d)(2).”

(5) Section 530(d)(2) is amended by adding at the end the following new subparagraph:

“(D) **DISALLOWANCE OF EXCLUDED AMOUNTS AS CREDIT OR DEDUCTION.**—No deduction or credit shall be allowed to

the taxpayer under any other section of this chapter for any qualified education expenses to the extent taken into account in determining the amount of the exclusion under this paragraph.”.

(6) Section 530(d)(4)(B) is amended by striking “or” at the end of clause (ii), by striking the period at the end of clause (iii) and inserting “, or”, and by adding at the end the following new clause:

“(iv) an amount which is includible in gross income solely because the taxpayer elected under paragraph (2)(C) to waive the application of paragraph (2) for the taxable year.”.

(7) So much of section 530(d)(4)(C) as precedes clause (ii) thereof is amended to read as follows:

“(C) 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 the designated beneficiary if—

“(i) such distribution is made on or before the day prescribed by law (including extensions of time) for filing the beneficiary’s return of tax for the taxable year or, if the beneficiary is not required to file such a return, the 15th day of the 4th month of the taxable year following the taxable year, and”.

(8) Section 135(c)(2)(C) is amended—

(A) by inserting “AND EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS” in the heading after “PROGRAM”, and

(B) by striking “section 529(c)(3)(A)” and inserting “section 72”.

(9) Section 4973(e)(1) is amended to read as follows:

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

“(A) the amount by which the amount contributed for the taxable year to such accounts exceeds \$500 (or, if less, the sum of the maximum amounts permitted to be contributed under section 530(c) by the contributors to such accounts for such year),

“(B) if any amount is contributed during such year to a qualified State tuition program for the benefit of such beneficiary, any amount contributed to such accounts for such taxable year, and

“(C) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

“(i) the distributions out of the accounts for the taxable year which are included in gross income, and

“(ii) the excess (if any) of the maximum amount which may be contributed to the accounts for the taxable year over the amount contributed to the accounts for the taxable year.”.

(10)(A) Paragraph (5) of section 530(d) is amended by striking the first sentence and inserting the following new sentence: “Paragraph (1) shall not apply to any amount paid or distributed from an education individual retirement account to the ex-

tent that the amount received is paid, not later than the 60th day after the date of such payment or distribution, into another education individual retirement account for the benefit of the same beneficiary or a member of the family (within the meaning of section 529(e)(2) of such beneficiary who has not attained age 30 as of such date.”

(B) Paragraph (6) of section 530(d) is amended by inserting before the period “and has not attained age 30 as of the date of such change”.

(f) **EFFECTIVE DATES.**—

(1) **IN GENERAL.**—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1998.

(2) **TECHNICAL CORRECTIONS.**—The amendments made by subsection (e) shall take effect as if included in the amendments made by section 213 of the Taxpayer Relief Act of 1997.

SEC. 102. EXCLUSION FROM GROSS INCOME OF EDUCATION DISTRIBUTIONS FROM QUALIFIED STATE TUITION PROGRAMS.

(a) **IN GENERAL.**—Section 529(c)(3)(B) (relating to distributions) is amended to read as follows:

“(B) **DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.**—

“(i) **IN GENERAL.**—No amount shall be includible in gross income under subparagraph (A) 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.

“(ii) **DISTRIBUTIONS IN EXCESS OF EXPENSES.**—If such aggregate distributions exceed such expenses during the taxable year, the amount otherwise includible in gross income under subparagraph (A) shall be reduced by the amount which bears the same ratio to the amount so includible (without regard to this subparagraph) as such expenses bear to such aggregate distributions.

“(iii) **ELECTION TO WAIVE EXCLUSION.**—A taxpayer may elect to waive the application of this subparagraph for any taxable year.

“(iv) **IN-KIND DISTRIBUTIONS.**—Any benefit furnished to a designated beneficiary under a qualified State tuition program shall be treated as a distribution to the beneficiary for purposes of this paragraph.

“(v) **DISALLOWANCE OF EXCLUDED AMOUNTS AS CREDIT OR DEDUCTION.**—No deduction or credit shall be allowed to the taxpayer under any other section of this chapter for any qualified higher education expenses to the extent taken into account in determining the amount of the exclusion under this paragraph.”.

(b) **DEFINITION OF QUALIFIED HIGHER EDUCATION EXPENSES.**—Section 529(e)(3)(A) (defining qualified higher education expenses) is amended to read as follows:

“(A) **IN GENERAL.**—The term ‘qualified higher education expenses’ means expenses for tuition, fees, academic tutoring, special needs services, books, supplies, computer

equipment (including related software and services), and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary at an eligible educational institution.”.

(c) **COORDINATION WITH EDUCATION CREDITS.**—Section 25A(e)(2) (relating to coordination with exclusions) is amended—

(1) by inserting “a qualified State tuition program or” before “an education individual retirement account”, and

(2) by striking “section 530(d)(2)” and inserting “section 529(c)(3)(B) or 530(d)(2)”.

(d) **ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.**—

(1) **IN GENERAL.**—Section 529(b)(1) (defining qualified State tuition program) is amended by inserting “or, in the case of taxable years beginning after December 31, 2005, by 1 or more eligible educational institutions” after “maintained by a State or agency or instrumentality thereof”.

(2) **PRIVATE QUALIFIED TUITION PROGRAMS LIMITED TO BENEFIT PLANS.**—Section 529(b)(1) is amended by adding at the end the following flush sentence:

“Clause (ii) of subparagraph (A) shall only apply to a program established and maintained by a State or agency or instrumentality thereof.”.

(3) **LIMITATION ON CONTRIBUTIONS TO PRIVATE QUALIFIED TUITION PROGRAMS.**—Section 529(b) is amended by adding at the end the following new paragraph:

“(8) **LIMITATION ON CONTRIBUTIONS TO PRIVATE QUALIFIED TUITION PROGRAMS.**—In the case of a program not established and maintained by a State or agency or instrumentality thereof, such program shall not be treated as a qualified tuition program unless it limits the annual contribution to the program on behalf of a designated beneficiary to an amount equal to the lesser of—

“(A) \$5,000, or

“(B) the excess of—

“(i) \$50,000, over

“(ii) the aggregate amount contributed to such program on behalf of such beneficiary for all prior taxable years.”.

(4) **TAX ON EXCESS CONTRIBUTIONS.**—

(A) **IN GENERAL.**—Section 4973(a) (relating to tax imposed) is amended by striking “or” at the end of paragraph (3), by inserting “or” at the end of paragraph (4), and by inserting after paragraph (4) the following new paragraph:

“(5) a private qualified tuition program (as defined in subsection (g)),”.

(B) **EXCESS CONTRIBUTIONS DEFINED.**—Section 4973 is amended by adding at the end the following new subsection:

“(g) **EXCESS CONTRIBUTIONS TO PRIVATE QUALIFIED TUITION PROGRAM.**—For purposes of this section—

“(1) **IN GENERAL.**—In the case of private qualified tuition programs, the term ‘excess contributions’ means, with respect to any 1 beneficiary—

“(A) the amount by which the amounts contributed for the taxable year to such programs exceed the lesser of—

“(i) \$5,000, or

“(ii) the excess of—

“(I) \$50,000, over

“(II) the aggregate amount contributed to all private qualified tuition programs on behalf of such beneficiary for all prior taxable years, and

“(B) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

“(i) the distributions out of such programs for the taxable year which are included in gross income, and

“(ii) the excess (if any) of the maximum amount which may be contributed to such programs for the taxable year over the amount contributed to such programs for the taxable year.

“(2) **SPECIAL RULE IF CONTRIBUTIONS MADE TO A STATE TUITION PROGRAM OR AN EDUCATION INDIVIDUAL RETIREMENT ACCOUNT.**—Notwithstanding paragraph (1), with respect to any 1 beneficiary, the amount contributed to a private qualified tuition program for any taxable year shall be treated as excess contributions if any amount is contributed during such year for the benefit of such beneficiary to—

“(A) a qualified tuition program (as defined in section 529) that is established and maintained by a State or any agency or instrumentality thereof, or

“(B) an education individual retirement account (as defined in section 530).

“(3) **SPECIAL RULES.**—The contributions described in subsection (e)(2) shall not be taken into account.

“(4) **PRIVATE QUALIFIED TUITION PROGRAM.**—The term ‘private qualified tuition program’ means a qualified tuition program (as defined in section 529) not established and maintained by a State or any agency or instrumentality thereof.”

(5) **TECHNICAL AMENDMENTS.**—

(A) The text of each of the sections 72(e)(9), 529, 530(b)(2)(B), and 4973(e)(1)(B) is amended by striking “qualified State tuition program” each place it appears and inserting “qualified tuition program”.

(B)(i) The section heading of section 529 is amended to read as follows:

“SEC. 529. QUALIFIED TUITION PROGRAMS.”

(ii) The item relating to section 529 in the table of sections for part VIII of subchapter F of chapter 1 is amended by striking “State”.

(e) **TECHNICAL CORRECTIONS.**—

(1) Section 135(c)(3) is amended to read as follows:

“(3) **ELIGIBLE EDUCATIONAL INSTITUTION.**—The term ‘eligible educational institution’ has the meaning given such term by section 529(e)(5).”

(2) Section 529(c)(3)(A) is amended by striking “section 72(b)” and inserting “section 72”.

(3) Section 529(e)(2) is amended to read as follows:

“(2) **MEMBER OF FAMILY.**—The term ‘member of the family’ means, with respect to any designated beneficiary—

“(A) the spouse of such beneficiary,

“(B) an individual who bears a relationship to such beneficiary which is described in paragraphs (1) through (8) of section 152(a), and

“(C) the spouse of any individual described in subparagraph (B).”.

(f) **EFFECTIVE DATES.**—

(1) **IN GENERAL.**—Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to taxable years beginning after December 31, 1998.

(2) **ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.**—The amendments made by subsection (d) shall apply to taxable years beginning after December 31, 2005.

(3) **TECHNICAL CORRECTIONS.**—The amendments made by subsection (e) shall take effect as if included in the amendments made by section 211 of the Taxpayer Relief Act of 1997.

SEC. 103. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

Section 127(d) (relating to termination of exclusion for educational assistance programs) is amended by striking “May 31, 2000” and inserting “December 31, 2002”.

SEC. 104. ADDITIONAL INCREASE IN ARBITRAGE REBATE EXCEPTION FOR GOVERNMENTAL BONDS USED TO FINANCE EDUCATION FACILITIES.

(a) **IN GENERAL.**—Section 148(f)(4)(D)(vii) (relating to increase in exception for bonds financing public school capital expenditures) is amended by striking “\$5,000,000” the second place it appears and inserting “\$10,000,000”.

(b) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall apply to obligations issued after December 31, 1998.

SEC. 105. EXCLUSION OF CERTAIN AMOUNTS RECEIVED UNDER THE NATIONAL HEALTH CORPS SCHOLARSHIP PROGRAM AND THE F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM.

(a) **IN GENERAL.**—Section 117(c) (relating to the exclusion from gross income amounts received as a qualified scholarship) is amended—

(1) by striking “Subsections (a)” and inserting the following:

“(1) **IN GENERAL.**—Except as provided in paragraph (2), subsections (a)”; and

(2) by adding at the end the following new paragraph:

“(2) **EXCEPTIONS.**—Paragraph (1) shall not apply to any amount received by an individual under—

“(A) the National Health Corps Scholarship Program under section 338A(g)(1)(A) of the Public Health Service Act, or

“(B) the Armed Forces Health Professions Scholarship and Financial Assistance program under subchapter I of chapter 105 of title 10, United States Code.”.

(b) *EFFECTIVE DATE.*—The amendments made by subsection (a) shall apply to amounts received in taxable years beginning after December 31, 1993.

Subtitle B—Revenue

SEC. 111. OVERRULING OF SCHMIDT BAKING COMPANY CASE.

(a) *IN GENERAL.*—Section 404(a) (relating to general rule) is amended by adding at the end the following new paragraph:

“(11) *DETERMINATIONS RELATING TO DEFERRED COMPENSATION.*—For purposes of determining under this section—

“(A) whether compensation of an employee is deferred compensation, and

“(B) when deferred compensation is paid, no amount shall be treated as received by the employee, or paid, until it is actually received by the employee.”.

(b) *EFFECTIVE DATE.*—

(1) *IN GENERAL.*—The amendment made by subsection (a) shall apply to taxable years ending after December 31, 2001.

(2) *PHASE-IN OF INCREASE.*—In the case of the first taxable year of the taxpayer ending after December 31, 2001, only 60 percent of the amount of the increase in tax resulting from the amendment made by subsection (a) shall be taken into account for purposes of sections 6654 and 6655 of the Internal Revenue Code of 1986 (relating to failure to pay estimated income tax).

(3) *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 December 31, 2001—

(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.

Subtitle C—Identification of Limited Tax Benefits Subject To Line Item Veto

SEC. 121. IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO.

Section 1021(a)(3) of the Congressional Budget and Impoundment Control Act of 1974 shall only apply to section 104(a) (relating to additional increase in arbitrage rebate exception for governmental bonds used to finance education facilities).

TITLE II—MEASURES TO ENCOURAGE RESULTS IN TEACHING

SEC. 201. STATE INCENTIVES FOR TEACHER TESTING AND MERIT PAY.

(a) *SHORT TITLE.*—This section may be cited as the “Measures to Encourage Results in Teaching Act of 1998”.

(b) *FINDINGS.*—Congress makes the following findings:

(1) *All students deserve to be taught by well-educated, competent, and qualified teachers.*

(2) *More than ever before, education has and will continue to become the ticket not only to economic success but to basic survival. Students will not succeed in meeting the demands of a knowledge-based, 21st century society and economy if the students do not encounter more challenging work in school. For future generations to have the opportunities to achieve success the future generations will need to have an education and a teacher workforce second to none.*

(3) *No other intervention can make the difference that a knowledgeable, skillful teacher can make in the learning process. At the same time, nothing can fully compensate for weak teaching that, despite good intentions, can result from a teacher's lack of opportunity to acquire the knowledge and skill needed to help students master the curriculum.*

(4) *The Federal Government established the Dwight D. Eisenhower Professional Development Program in 1985 to ensure that teachers and other educational staff have access to sustained and high-quality professional development. This ongoing development must include the ability to demonstrate and judge the performance of teachers and other instructional staff.*

(5) *States should evaluate their teachers on the basis of demonstrated ability, including tests of subject matter knowledge, teaching knowledge, and teaching skill. States should develop a test for their teachers and other instructional staff with respect to the subjects taught by the teachers and staff, and should administer the test every 3 to 5 years.*

(6) *Evaluating and rewarding teachers with a compensation system that supports teachers who become increasingly expert in a subject area, are proficient in meeting the needs of students and schools, and demonstrate high levels of performance measured against professional teaching standards, will encourage teachers to continue to learn needed skills and broaden teachers' expertise, thereby enhancing education for all students.*

(c) **PURPOSES.**—*The purposes of this section are as follows:*

(1) *To provide incentives for States to establish and administer periodic teacher testing and merit pay programs for elementary school and secondary school teachers.*

(2) *To encourage States to establish merit pay programs that have a significant impact on teacher salary scales.*

(3) *To encourage programs that recognize and reward the best teachers, and encourage those teachers that need to do better.*

(d) **STATE INCENTIVES FOR TEACHER TESTING AND MERIT PAY.**—

(1) **AMENDMENTS.**—*Title II of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6601 et seq.) is amended—*

(A) *by redesignating part D as part F;*

(B) *by redesignating sections 2401 and 2402 as sections 2601 and 2602, respectively; and*

(C) *by inserting after part C the following:*

**“PART D—STATE INCENTIVES FOR TEACHER
TESTING AND MERIT PAY**

**“SEC. 2401. STATE INCENTIVES FOR TEACHER TESTING AND MERIT
PAY.**

“(a) STATE AWARDS.—Notwithstanding any other provision of this title, from funds described in subsection (b) that are made available for a fiscal year, the Secretary shall make an award to each State that—

“(1) administers a test to each elementary school and secondary school teacher in the State, with respect to the subjects taught by the teacher, every 3 to 5 years; and

“(2) has an elementary school and secondary school teacher compensation system that is based on merit.

“(b) AVAILABLE FUNDING.—The amount of funds referred to in subsection (a) that are available to carry out this section for a fiscal year is 50 percent of the amount of funds appropriated to carry out this title that are in excess of the amount so appropriated for fiscal year 1999, except that no funds shall be available to carry out this section for any fiscal year for which—

“(1) the amount appropriated to carry out this title exceeds \$600,000,000; or

“(2) each of the several States is eligible to receive an award under this section.

“(c) AWARD AMOUNT.—A State shall receive an award under this section in an amount that bears the same relation to the total amount available for awards under this section for a fiscal year as the number of States that are eligible to receive such an award for the fiscal year bears to the total number of all States so eligible for the fiscal year.

“(d) USE OF FUNDS.—Funds provided under this section may be used by States to carry out the activities described in section 2207.

“(e) DEFINITION OF STATE.—For the purpose of this section, the term ‘State’ means each of the 50 States and the District of Columbia.”.

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall take effect on October 2, 1999.

(e) TEACHER TESTING AND MERIT PAY.—

(1) IN GENERAL.—Notwithstanding any other provision of law, a State may use Federal education funds—

(A) to carry out a test of each elementary school or secondary school teacher in the State with respect to the subjects taught by the teacher; or

(B) to establish a merit pay program for the teachers.

(2) DEFINITIONS.—In this subsection, the terms “elementary school” and “secondary school” have the meanings given the terms in section 14101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 8801).

TITLE III—EQUAL EDUCATIONAL OPPORTUNITY

SEC. 301. EQUAL EDUCATIONAL OPPORTUNITY.

Subsection (b) of section 6301 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 7351) is amended—

- (1) in paragraph (7), by striking “and” after the semicolon;
- (2) in paragraph (8), by striking the period and inserting “; and”; and
- (3) by adding at the end the following:
“(9) education reform projects that provide same gender schools and classrooms, as long as comparable educational opportunities are offered for students of both sexes.”.

TITLE IV—SENSE OF CONGRESS

SEC. 401. FINDINGS.

Congress makes the following findings:

(1) *The people of the United States know that effective teaching takes place when the people of the United States begin (A) helping children master basic academics, (B) engaging and involving parents, (C) creating safe and orderly classrooms, and (D) getting dollars to the classroom.*

(2) *Our Nation’s children deserve an educational system which will provide opportunities to excel.*

(3) *States and localities must spend a significant amount of Federal education tax dollars applying for and administering Federal education dollars.*

(4) *Several States have reported that although the States receive less than 10 percent of their education funding from the Federal Government, more than 50 percent of their paperwork is associated with those Federal dollars.*

(5) *While it is unknown exactly what percentage of Federal education dollars reaches the classroom, a recent audit of New York City public schools found that only 43 percent of their local education budget reaches the classroom; further, it is thought that only 85 percent of funds administered by the Department of Education for elementary and secondary education reach the school district level; and even if 65 percent of Federal education funds reach the classroom, it still means that billions of dollars are not directly spent on children in the classroom.*

(6) *American students are not performing up to their full academic potential, despite the more than 760 Federal education programs, which span 39 Federal agencies at the price of nearly \$100,000,000,000 annually.*

(7) *According to the Digest of Education Statistics, in 1993 only \$141,598,786,000 out of \$265,285,370,000 spent on elementary and secondary education was spent on instruction.*

(8) *According to the National Center for Education Statistics, in 1994 only 52 percent of staff employed in public elementary and secondary school systems were teachers.*

(9) *Too much of our Federal education funding is spent on bureaucracy, and too little is spent on our Nation’s youth.*

(10) *Getting 95 percent of Department of Education elementary and secondary education funds to the classroom could provide approximately \$2,094 in additional funding per classroom across the United States.*

(11) *More education funding should be put in the hands of someone in a child’s classroom who knows the child’s name.*

(12) *President Clinton has stated: “We cannot ask the American people to spend more on education until we do a better job with the money we’ve got now.”*

(13) *President Clinton and Vice President Gore agree that the reinventing of public education will not begin in Washington but in communities across the United States and that the people of the United States must ask fundamental questions about how our Nation’s public school systems’ dollars are spent.*

(14) *President Clinton and Vice President Gore agree that in an age of tight budgets, our Nation should be spending public funds on teachers and children, not on unnecessary overhead and bloated bureaucracy.*

SEC. 402. SENSE OF CONGRESS.

It is the sense of Congress that the Department of Education, States, and local educational agencies should work together to ensure that not less than 95 percent of all funds appropriated for the purpose of carrying out elementary and secondary education programs administered by the Department of Education is spent for our Nation’s children in their classrooms.

TITLE V—READING EXCELLENCE

SEC. 501. SHORT TITLE.

This title may be cited as the “Reading Excellence Act”.

Subtitle A—Reading Grants

SEC. 511. AMENDMENT TO ESEA FOR READING GRANTS.

Title II of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6601 et seq.) is amended further by inserting after part D (as inserted by section 201(d)(1)(C) of this Act) the following:

“PART E—READING GRANTS

“SEC. 2501. PURPOSE.

“The purposes of this part are as follows:

“(1) To teach every child to read in their early childhood years—

“(A) as soon as they are ready to read; or

“(B) as soon as possible once they enter school, but not later than 3d grade.

“(2) To improve the reading skills of students, and the in-service instructional practices for teachers who teach reading, through the use of findings from reliable, replicable research on reading, including phonics.

“(3) To expand the number of high-quality family literacy programs.

“(4) To reduce the number of children who are inappropriately referred to special education due to reading difficulties.

“SEC. 2502. DEFINITIONS.

“For purposes of this part:

“(1) ELIGIBLE PROFESSIONAL DEVELOPMENT PROVIDER.—The term ‘eligible professional development provider’ means a provider of professional development in reading instruction to

teachers that is based on reliable, replicable research on reading.

“(2) ELIGIBLE RESEARCH INSTITUTION.—The term ‘eligible research institution’ means an institution of higher education at which reliable, replicable research on reading has been conducted.

“(3) FAMILY LITERACY SERVICES.—The term ‘family literacy services’ means services provided to participants on a voluntary basis that are of sufficient intensity in terms of hours, and of sufficient duration, to make sustainable changes in a family (such as eliminating or reducing welfare dependency) and that integrate all of the following activities:

“(A) Interactive literacy activities between parents and their children.

“(B) Equipping parents to partner with their children in learning.

“(C) Parent literacy training, including training that contributes to economic self-sufficiency.

“(D) Appropriate instruction for children of parents receiving parent literacy services.

“(4) READING.—The term ‘reading’ means the process of comprehending the meaning of written text by depending on—

“(A) the ability to use phonics skills, that is, knowledge of letters and sounds, to decode printed words quickly and effortlessly, both silently and aloud;

“(B) the ability to use previously learned strategies for reading comprehension; and

“(C) the ability to think critically about the meaning, message, and aesthetic value of the text.

“(5) READING READINESS.—The term ‘reading readiness’ means activities that—

“(A) provide experience and opportunity for language development;

“(B) create appreciation of the written word;

“(C) develop an awareness of printed language, the alphabet, and phonemic awareness; and

“(D) develop an understanding that spoken and written language is made up of phonemes, syllables, and words.

“(6) RELIABLE, REPLICABLE RESEARCH.—The term ‘reliable, replicable research’ means objective, valid, scientific studies that—

“(A) include rigorously defined samples of subjects that are sufficiently large and representative to support the general conclusions drawn;

“(B) rely on measurements that meet established standards of reliability and validity;

“(C) test competing theories, where multiple theories exist;

“(D) are subjected to peer review before their results are published; and

“(E) discover effective strategies for improving reading skills.

“SEC. 2503. GRANTS TO READING AND LITERACY PARTNERSHIPS.

“(a) PROGRAM AUTHORIZED.—The Secretary may make grants on a competitive basis to reading and literacy partnerships for the purpose of permitting such partnerships to make subgrants under sections 2504 and 2505.

“(b) READING AND LITERACY PARTNERSHIPS.—

“(1) COMPOSITION.—

“(A) REQUIRED PARTICIPANTS.—In order to receive a grant under this section, a State shall establish a reading and literacy partnership consisting of at least the following participants:

“(i) The Governor of the State.

“(ii) The chief State school officer.

“(iii) The chairman and the ranking member of each committee of the State legislature that is responsible for education policy.

“(iv) A representative, selected jointly by the Governor and the chief State school officer, of at least 1 local educational agency that has at least 1 school that is identified for school improvement under section 1116(c) in the geographic area served by the agency.

“(v) A representative, selected jointly by the Governor and the chief State school officer, of a community-based organization working with children to improve their reading skills, particularly a community-based organization using volunteers.

“(B) OPTIONAL PARTICIPANTS.—A reading and literacy partnership may include additional participants, who shall be selected jointly by the Governor and the chief State school officer, which may include—

“(i) State directors of appropriate Federal or State programs with a strong reading component;

“(ii) a parent of a public or private school student or a parent who educates their child or children in their home;

“(iii) a teacher who teaches reading; or

“(iv) a representative of (I) an institution of higher education operating a program of teacher preparation in the State; (II) a local educational agency; (III) an eligible research institution; (IV) a private nonprofit or for-profit eligible professional development provider providing instruction based on reliable, replicable research on reading; (V) a family literacy service provider; (VI) an adult education provider; (VII) a volunteer organization that is involved in reading programs; or (VIII) a school or a public library that offers reading or literacy programs for children or families.

“(2) AGREEMENT.—The contractual agreement that establishes a reading and literacy partnership—

“(A) shall specify—

“(i) the nature and extent of the association among the participants referred to in paragraph (1); and

“(ii) the roles and duties of each such participant; and

“(B) shall remain in effect during the entire grant period proposed in the partnership’s grant application under subsection (e).”

“(3) FUNCTIONS.—Each reading and literacy partnership for a State shall prepare and submit an application under subsection (e) and, if the partnership receives a grant under this section—

“(A) shall solicit applications for, and award, subgrants under sections 2504 and 2505;

“(B) shall oversee the performance of the subgrants and submit performance reports in accordance with subsection (h);

“(C) if sufficient grant funds are available under this part—

“(i) work to enhance the capacity of agencies in the State to disseminate reliable, replicable research on reading to schools, classrooms, and providers of early education and child care;

“(ii) facilitate the provision of technical assistance to subgrantees under sections 2504 and 2505 by providing the subgrantees information about technical assistance providers; and

“(iii) build on, and promote coordination among, literacy programs in the State, in order to increase their effectiveness and to avoid duplication of their efforts; and

“(D) shall ensure that each local educational agency to which the partnership makes a subgrant under section 2504 makes available, upon request and in an understandable and uniform format, to any parent of a student attending any school selected under section 2504(a)(2) in the geographic area served by the agency, information regarding the qualifications of the student’s classroom teacher to provide instruction in reading.

“(4) FISCAL AGENT.—The State educational agency shall act as the fiscal agent for the reading and literacy partnership for the purposes of receipt of funds from the Secretary, disbursement of funds to subgrantees under sections 2504 and 2505, and accounting for such funds.

“(c) PREEXISTING PARTNERSHIP.—If, before the date of the enactment of the Reading Excellence Act, a State established a consortium, partnership, or any other similar body, that includes the Governor and the chief State school officer and has, as a central part of its mission, the promotion of literacy for children in their early childhood years through the 3d grade, but that does not satisfy the requirements of subsection (b)(1), the State may elect to treat that consortium, partnership, or body as the reading and literacy partnership for the State notwithstanding such subsection, and the consortium, partnership, or body shall be considered a reading and literacy partnership for purposes of the other provisions of this part.

“(d) MULTI-STATE PARTNERSHIP ARRANGEMENTS.—A reading and literacy partnership that satisfies the requirements of subsection (b) may join with other such partnerships in other States to develop a single application that satisfies the requirements of sub-

section (e) and identifies which State educational agency, from among the States joining, shall act as the fiscal agent for the multi-State arrangement. For purposes of the other provisions of this part, any such multi-State arrangement shall be considered to be a reading and literacy partnership.

“(e) APPLICATIONS.—A reading and literacy partnership that desires to receive a grant under this section shall submit an application to the Secretary at such time, in such manner, and including such information as the Secretary may require. The application—

“(1) shall describe how the partnership will ensure that 95 percent of the grant funds are used to make subgrants under sections 2504 and 2505;

“(2) shall be integrated, to the maximum extent possible, with State plans and programs under this Act, the Individuals with Disabilities Education Act (20 U.S.C. 1400 et seq.), and, to the extent appropriate, the Adult Education Act (20 U.S.C. 1201 et seq.);

“(3) shall describe how the partnership will ensure that professional development funds available at the State and local levels are used effectively to improve instructional practices for reading and are based on reliable, replicable research on reading;

“(4) shall describe—

“(A) the contractual agreement that establishes the partnership, including at least the elements of the agreement referred to in subsection (b)(2);

“(B) how the partnership will assess, on a regular basis, the extent to which the activities undertaken by the partnership and the partnership’s subgrantees under this part have been effective in achieving the purposes of this part;

“(C) what evaluation instruments the partnership will use to determine the success of local educational agencies to whom subgrants under sections 2504 and 2505 are made in achieving the purposes of this part;

“(D) how subgrants made by the partnership under such sections will meet the requirements of this part, including how the partnership will ensure that subgrantees will use practices based on reliable, replicable research on reading; and

“(E) how the partnership will, to the extent practicable, make grants to subgrantees in both rural and urban areas;

“(5) shall include an assurance that each local educational agency to whom the partnership makes a subgrant under section 2504—

“(A) will carry out family literacy programs based on the Even Start family literacy model authorized under part B of title I to enable parents to be their child’s first and most important teacher, and will make payments for the receipt of technical assistance for the development of such programs;

“(B) will carry out programs to assist those kindergarten students who are not ready for the transition to 1st

grade, particularly students experiencing difficulty with reading skills;

“(C) will use supervised individuals (including tutors), who have been appropriately trained using reliable, replicable research on reading, to provide additional support, before school, after school, on weekends, during non-instructional periods of the school day, or during the summer, for students in grades 1 through 3 who are experiencing difficulty reading; and

“(D) will carry out professional development for the classroom teacher and other appropriate teaching staff on the teaching of reading based on reliable, replicable research on reading; and

“(6) shall describe how the partnership—

“(A) will ensure that a portion of the grant funds that the partnership receives in each fiscal year will be used to make subgrants under section 2505; and

“(B) will make local educational agencies described in section 2505(a)(1) aware of the availability of such subgrants.

“(f) **PEER REVIEW PANEL.**—

“(1) **COMPOSITION OF PEER REVIEW PANEL.**—

“(A) **IN GENERAL.**—The National Institute for Literacy, in consultation with the National Research Council of the National Academy of Sciences, the National Institute of Child Health and Human Development, and the Secretary, shall convene a panel to evaluate applications under this section. At a minimum the panel shall include representatives of the National Institute for Literacy, the National Research Council of the National Academy of Sciences, the National Institute of Child Health and Human Development, and the Secretary.

“(B) **EXPERTS.**—The panel shall include experts who are competent, by virtue of their training, expertise, or experience, to evaluate applications under this section, and experts who provide professional development to teachers of reading to children and adults, based on reliable, replicable research on reading.

“(C) **LIMITATION.**—Not more than $\frac{1}{3}$ of the panel may be composed of individuals who are employees of the Federal Government.

“(2) **PAYMENT OF FEES AND EXPENSES OF CERTAIN MEMBERS.**—The Secretary shall use funds reserved under section 2510(b)(2) to pay the expenses and fees of panel members who are not employees of the Federal Government.

“(3) **DUTIES OF PANEL.**—

“(A) **MODEL APPLICATION FORMS.**—The peer review panel shall develop a model application form for reading and literacy partnerships desiring to apply for a grant under this section. The peer review panel shall submit the model application form to the Secretary for final approval.

“(B) **SELECTION OF APPLICATIONS.**—

“(i) **RECOMMENDATIONS OF PANEL.**—

“(I) IN GENERAL.—The Secretary shall receive grant applications from reading and literacy partnerships under this section and shall provide the applications to the peer review panel for evaluation. With respect to each application, the peer review panel shall initially recommend the application for funding or for disapproval.

“(II) PRIORITY.—In recommending applications to the Secretary, the panel shall give priority to applications from States that have modified, are modifying, or provide an assurance that not later than 1 year after receiving a grant under this section the State will modify, State teacher certification in the area of reading to reflect reliable, replicable research, except that nothing in this part shall be construed to establish a national system of teacher certification.

“(III) RANKING OF APPLICATIONS.—With respect to each application recommended for funding, the panel shall assign the application a rank, relative to other recommended applications, based on the priority described in subclause (II), the extent to which the application furthers the purposes of this part, and the overall quality of the application.

“(IV) RECOMMENDATION OF AMOUNT.—With respect to each application recommended for funding, the panel shall make a recommendation to the Secretary with respect to the amount of the grant that should be made.

“(ii) SECRETARIAL SELECTION.—

“(I) IN GENERAL.—Subject to clause (iii), the Secretary shall determine, based on the peer review panel’s recommendations, which applications from reading and literacy partnerships shall receive funding and the amounts of such grants. In determining grant amounts, the Secretary shall take into account the total amount of funds available for all grants under this section and the types of activities proposed to be carried out by the partnership.

“(II) EFFECT OF RANKING BY PANEL.—In making grants under this section, the Secretary shall select applications according to the ranking of the applications by the peer review panel, except in cases where the Secretary determines, for good cause, that a variation from that order is appropriate.

“(iii) MINIMUM GRANT AMOUNTS.—Each reading and literacy partnership selected to receive a grant under this section shall receive an amount for each fiscal year that is not less than \$100,000.

“(g) LIMITATION ON ADMINISTRATIVE EXPENSES.—A reading and literacy partnership that receives a grant under this section

may use not more than 3 percent of the grant funds for administrative costs.

“(h) REPORTING.—

“(1) IN GENERAL.—A reading and literacy partnership that receives a grant under this section shall submit performance reports to the Secretary pursuant to a schedule to be determined by the Secretary, but not more frequently than annually. Such reports shall include—

“(A) the results of use of the evaluation instruments referred to in subsection (e)(4)(C);

“(B) the process used to select subgrantees;

“(C) a description of the subgrantees receiving funds under this part; and

“(D) with respect to subgrants under section 2504, the model or models of reading instruction, based on reliable, replicable research on reading, selected by subgrantees.

“(2) PROVISION TO PEER REVIEW PANEL.—The Secretary shall provide the reports submitted under paragraph (1) to the peer review panel convened under subsection (f). The panel shall use such reports in recommending applications for funding under this section.

“SEC. 2504. LOCAL READING IMPROVEMENT SUBGRANTS.

“(a) IN GENERAL.—

“(1) SUBGRANTS.—A reading and literacy partnership that receives a grant under section 2503 shall make subgrants, on a competitive basis, to local educational agencies that have at least 1 school that is identified for school improvement under section 1116(c) in the geographic area served by the agency.

“(2) ROLE OF LOCAL EDUCATIONAL AGENCIES.—A local educational agency that receives a subgrant under this section shall use the subgrant in a manner consistent with this section to advance reform of reading instruction in any school selected by the agency that—

“(A) is identified for school improvement under section 1116(c) at the time the agency receives the subgrant; and

“(B) has a contractual association with 1 or more community-based organizations that have established a record of effectiveness with respect to reading readiness, reading instruction for children in kindergarten through 3d grade, and early childhood literacy.

“(b) GRANT PERIOD.—A subgrant under this section shall be for a period of 3 years and may not be revoked or terminated on the ground that a school ceases, during the grant period, to be identified for school improvement under section 1116(c).

“(c) APPLICATIONS.—A local educational agency that desires to receive a subgrant under this section shall submit an application to the reading and literacy partnership at such time, in such manner, and including such information as the partnership may require. The application—

“(1) shall describe how the local educational agency will work with schools selected by the agency under subsection (a)(2) to select 1 or more models of reading instruction, developed using reliable, replicable research on reading, as a model for implementing and improving reading instruction by all teach-

ers and for all children in each of the schools selected by the agency under such subsection and, where appropriate, their parents;

“(2) shall select 1 or more models described in paragraph (1), for the purpose described in such paragraph, and shall describe each such selected model;

“(3) shall demonstrate that a person responsible for the development of each such model, or a person with experience or expertise about such model and its implementation, has agreed to work with the applicant in connection with such implementation and improvement efforts;

“(4) shall describe—

“(A) how the applicant will ensure that funds available under this part, and funds available for reading for grades kindergarten through grade 6 from other appropriate sources, are effectively coordinated and, where appropriate, integrated, with funds under this Act in order to improve existing activities in the areas of reading instruction, professional development, program improvement, parental involvement, technical assistance, and other activities that can help meet the purposes of this part; and

“(B) the amount of funds available for reading for grades kindergarten through grade 6 from appropriate sources other than this part, including title I (except that such description shall not be required to include funds made available under part B of title I unless the applicant has established a contractual association in accordance with subsection (d)(2) with an eligible entity under such part B), the Individuals with Disabilities Education Act (20 U.S.C. 1400 et seq.), and any other law providing Federal financial assistance for professional development for teachers of such grades who teach reading, which will be used to help achieve the purposes of this part;

“(5) shall describe the amount and nature of funds from any other public or private sources, including funds received under this Act and the Individuals with Disabilities Education Act (20 U.S.C. 1400 et seq.), that will be combined with funds received under the subgrant;

“(6) shall include an assurance that the applicant—

“(A) will carry out family literacy programs based on the Even Start family literacy model authorized under part B of title I to enable parents to be their child’s first and most important teacher, will make payments for the receipt of technical assistance for the development of such programs;

“(B) will carry out programs to assist those kindergarten students who are not ready for the transition to 1st grade, particularly students experiencing difficulty with reading skills;

“(C) will use supervised individuals (including tutors), who have been appropriately trained using reliable, replicable research on reading, to provide additional support, before school, after school, on weekends, during non-instructional periods of the school day, or during the sum-

mer, for students in grades 1 through 3 who are experiencing difficulty reading; and

“(D) will carry out professional development for the classroom teacher and other teaching staff on the teaching of reading based on reliable, replicable research on reading;

“(7) shall describe how the local educational agency provides instruction in reading to children who have not been determined to be a child with a disability (as defined in section 602 of the Individuals with Disabilities Education Act (20 U.S.C. 1401)), pursuant to section 614(b)(5) of such Act (20 U.S.C. 1414(a)(5)), because of a lack of instruction in reading; and

“(8) shall indicate the amount of the subgrant funds (if any) that the applicant will use to carry out the duties described in section 2505(b)(2).

“(d) PRIORITY.—In approving applications under this section, a reading and literacy partnership shall give priority to an application submitted by an applicant who demonstrates that the applicant has established—

“(1) a contractual association with 1 or more Head Start programs under the Head Start Act (42 U.S.C. 9801 et seq.) under which—

“(A) the Head Start program agrees to select the same model or models of reading instruction, as a model for implementing and improving the reading readiness of children participating in the program, as was selected by the applicant; and

“(B) the applicant agrees—

“(i) to share with the Head Start program an appropriate amount of the applicant’s information resources with respect to the model, such as curricula materials; and

“(ii) to train personnel from the Head Start program;

“(2) a contractual association with 1 or more State- or federally-funded preschool programs, or family literacy programs, under which—

“(A) the program agrees to select the same model or models of reading instruction, as a model for implementing and improving reading instruction in the program’s activities, as was selected by the applicant; and

“(B) the applicant agrees to train personnel from the program who work with children and parents in schools selected under subsection (a)(2); or

“(3) a contractual association with 1 or more public libraries providing reading or literacy services to preschool children, or preschool children and their families, under which—

“(A) the library agrees to select the same model or models of reading instruction, as a model for implementing and improving reading instruction in the library’s reading or literacy programs, as was selected by the applicant; and

“(B) the applicant agrees to train personnel, including volunteers, from such programs who work with preschool

children, or preschool children and their families, in schools selected under subsection (a)(2).

“(e) USE OF FUNDS.—

“(1) IN GENERAL.—Subject to paragraph (2), an applicant who receives a subgrant under this section may use the subgrant funds to carry out activities that are authorized by this part and described in the subgrant application, including the following:

“(A) Making reasonable payments for technical and other assistance to a person responsible for the development of a model of reading instruction, or a person with experience or expertise about such model and its implementation, who has agreed to work with the recipient in connection with the implementation of the model.

“(B) Carrying out a contractual agreement described in subsection (d).

“(C) Professional development (including training of volunteers), purchase of curricular and other supporting materials, and technical assistance.

“(D) Providing, on a voluntary basis, training to parents of children enrolled in a school selected under subsection (a)(2) on how to help their children with school work, particularly in the development of reading skills. Such training may be provided directly by the subgrant recipient, or through a grant or contract with another person. Such training shall be consistent with reading reforms taking place in the school setting.

“(E) Carrying out family literacy programs based on the Even Start family literacy model authorized under part B of title I to enable parents to be their child’s first and most important teacher, and making payments for the receipt of technical assistance for the development of such programs.

“(F) Providing instruction for parents of children enrolled in a school selected under subsection (a)(2), and others who volunteer to be reading tutors for such children, in the instructional practices based on reliable, replicable research on reading used by the applicant.

“(G) Programs to assist those kindergarten students enrolled in a school selected under subsection (a)(2) who are not ready for the transition to 1st grade, particularly students experiencing difficulty with reading skills.

“(H) Providing, for students who are enrolled in grades 1 through 3 in a school selected under subsection (a)(2) and are experiencing difficulty reading, additional support before school, after school, on weekends, during non-instructional periods of the school day, or during the summer, using supervised individuals (including tutors) who have been appropriately trained using reliable, replicable research on reading.

“(I) Carrying out the duties described in section 2505(b)(2) for children enrolled in a school selected under subsection (a)(2).

“(J) Providing reading assistance to children who have not been determined to be a child with a disability (as defined in section 602 of the Individuals with Disabilities Education Act (20 U.S.C. 1401)), pursuant to section 614(b)(5) of such Act (20 U.S.C. 1414(b)(5)), because of a lack of instruction in reading.

“(2) LIMITATION ON ADMINISTRATIVE EXPENSES.—A recipient of a subgrant under this section may use not more than 3 percent of the subgrant funds for administrative costs.

“(f) TRAINING NONRECIPIENTS.—A recipient of a subgrant under this section may train, on a fee-for-service basis, personnel who are from schools, or local educational agencies, that are not receiving such a subgrant in the instructional practices based on reliable, replicable research on reading used by the recipient. Such a non-recipient school may use funds received under title I, and other appropriate Federal funds used for reading instruction, to pay for such training, to the extent consistent with the law under which such funds were received.

“SEC. 2505. TUTORIAL ASSISTANCE SUBGRANTS.

“(a) IN GENERAL.—

“(1) SUBGRANTS.—A reading and literacy partnership that receives a grant under section 2503 shall make subgrants on a competitive basis to—

“(A) local educational agencies that have at least 1 school in the geographic area served by the agency that—

“(i) is located in an area designated as an empowerment zone under part I of subchapter U of chapter 1 of the Internal Revenue Code of 1986; or

“(ii) is located in an area designated as an enterprise community under part I of subchapter U of chapter 1 of the Internal Revenue Code of 1986; or

“(B) in the case of local educational agencies that do not have any such empowerment zone or enterprise community in the State in which the agency is located, local educational agencies that have at least 1 school that is identified for school improvement under section 1116(c) in the geographic area served by the agency.

“(2) APPLICATIONS.—A local educational agency that desires to receive a subgrant under this section shall submit an application to the reading and literacy partnership at such time, in such manner, and including such information as the partnership may require. The application shall include an assurance that the agency will use the subgrant funds to carry out the duties described in subsection (b) for children enrolled in 1 or more schools selected by the agency and described in paragraph (1).

“(b) USE OF FUNDS.—

“(1) IN GENERAL.—A local educational agency that receives a subgrant under this section shall carry out, using the funds provided under the subgrant, each of the duties described in paragraph (2).

“(2) DUTIES.—The duties described in this paragraph are the provision of tutorial assistance in reading to children who have difficulty reading, using instructional practices based on

the principles of reliable, replicable research, through the following:

“(A) The promulgation of a set of objective criteria, pertaining to the ability of a tutorial assistance provider successfully to provide tutorial assistance in reading, that will be used to determine in a uniform manner, at the beginning of each school year, the eligibility of tutorial assistance providers, subject to the succeeding subparagraphs of this paragraph, to be included on the list described in subparagraph (B) (and thereby be eligible to enter into a contract pursuant to subparagraph (F)).

“(B) The promulgation, maintenance, and approval of a list of tutorial assistance providers eligible to enter into a contract pursuant to subparagraph (F) who—

“(i) have established a record of effectiveness with respect to reading readiness, reading instruction for children in kindergarten through 3d grade, and early childhood literacy;

“(ii) are located in a geographic area convenient to the school or schools attended by the children who will be receiving tutorial assistance from the providers; and

“(iii) are capable of providing tutoring in reading to children who have difficulty reading, using instructional practices based on the principles of reliable, replicable research and consistent with the instructional methods used by the school the child attends.

“(C) The development of procedures (i) for the receipt of applications for tutorial assistance, from parents who are seeking such assistance for their child or children, that select a tutorial assistance provider from the list described in subparagraph (B) with whom the child or children will enroll, for tutoring in reading; and (ii) for considering children for tutorial assistance who are identified under subparagraph (D) and for whom no application has been submitted, provided that such procedures are in accordance with this paragraph and give such parents the right to select a tutorial assistance provider from the list referred to in subparagraph (B), and shall permit a local educational agency to recommend a tutorial assistance provider from the list under subparagraph (B) in a case where a parent asks for assistance in the making of such selection.

“(D) The development of a selection process for providing tutorial assistance in accordance with this paragraph that limits the provision of assistance to children identified, by the school the child attends, as having difficulty reading, including difficulty mastering essential phonic, decoding, or vocabulary skills. In the case of a child included in the selection process for whom no application has been submitted by a parent of the child, the child’s eligibility for receipt of tutorial assistance shall be determined under the same procedures, timeframe, and criteria for consideration as is used to determine the eligibility of a child whose parent has submitted such an application. Such local educational agency shall apply the provisions of subpara-

graphs (F) and (G) to a tutorial assistance provider selected for a child whose parent has not submitted an application pursuant to subparagraph (C)(i) in the same manner as the provisions are applied to a provider selected in an application submitted pursuant to subparagraph (C)(i).

“(E) The development of procedures for selecting children to receive tutorial assistance, to be used in cases where insufficient funds are available to provide assistance with respect to all children identified by a school under subparagraph (D) that—

“(i) gives priority to children who are determined, through State or local reading assessments, to be most in need of tutorial assistance; and

“(ii) gives priority, in cases where children are determined, through State or local reading assessments, to be equally in need of tutorial assistance, based on a random selection principle.

“(F) The development of a methodology by which payments are made directly to tutorial assistance providers who are identified and selected pursuant to subparagraphs (C), (D), and (E). Such methodology shall include the making of a contract, consistent with State and local law, between the tutorial assistance provider and the local educational agency carrying out this paragraph. Such contract—

“(i) shall contain specific goals and timetables with respect to the performance of the tutorial assistance provider;

“(ii) shall require the tutorial assistance provider to report to the parent and the local educational agency on the provider’s performance in meeting such goals and timetables; and

“(iii) shall contain provisions with respect to the making of payments to the tutorial assistance provider by the local educational agency.

“(G) The development of procedures under which the local educational agency carrying out this paragraph—

“(i) will ensure oversight of the quality and effectiveness of the tutorial assistance provided by each tutorial assistance provider that is selected for funding;

“(ii) will remove from the list under subparagraph (B) ineffective and unsuccessful providers (as determined by the local educational agency based upon the performance of the provider with respect to the goals and timetables contained in the contract between the agency and the provider under subparagraph (F));

“(iii) will provide to each parent of a child identified under subparagraph (D) who requests such information for the purpose of selecting a tutorial assistance provider for the child, in a comprehensible format, information with respect to the quality and effectiveness of the tutorial assistance referred to in clause (i); and

“(iv) will ensure that each school identifying a child under subparagraph (D) will provide upon re-

quest, to a parent of the child, assistance in selecting, from among the tutorial assistance providers who are included on the list described in subparagraph (B), the provider who is best able to meet the needs of the child.

“(c) *DEFINITION.*—For the purpose of this section the term ‘parent’ includes a legal guardian.

“SEC. 2506. PROGRAM EVALUATION.

“(a) *IN GENERAL.*—From funds reserved under section 2510(b)(1), the Secretary shall conduct a national assessment of the programs under this part. In developing the criteria for the assessment, the Secretary shall receive recommendations from the peer review panel convened under section 2503(f).

“(b) *SUBMISSION TO PEER REVIEW PANEL.*—The Secretary shall submit the findings from the assessment under subsection (a) to the peer review panel convened under section 2503(f).

“SEC. 2507. INFORMATION DISSEMINATION.

“(a) *IN GENERAL.*—From funds reserved under section 2510(b)(2), the National Institute for Literacy shall disseminate information on reliable, replicable research on reading and information on subgrantee projects under section 2504 or 2505 that have proven effective. At a minimum, the institute shall disseminate such information to all recipients of Federal financial assistance under titles I and VII, the Head Start Act (42 U.S.C. 9801 et seq.), the Individuals with Disabilities Education Act (20 U.S.C. 1400 et seq.), and the Adult Education Act (20 U.S.C. 1201 et seq.).

“(b) *COORDINATION.*—In carrying out this section, the National Institute for Literacy—

“(1) shall use, to the extent practicable, information networks developed and maintained through other public and private persons, including the Secretary, the National Center for Family Literacy, and the Readline Program;

“(2) shall work in conjunction with any panel convened by the National Institute of Child Health and Human Development and the Secretary, and any panel convened by the Office of Educational Research and Improvement to assess the current status of research-based knowledge on reading development, including the effectiveness of various approaches to teaching children to read, with respect to determining the criteria by which the National Institute for Literacy judges reliable, replicable research and the design of strategies to disseminate such information; and

“(3) shall assist any reading and literacy partnership selected to receive a grant under section 2503, and that requests such assistance—

“(A) in determining whether applications for subgrants submitted to the partnership meet the requirements of this part relating to reliable, replicable research on reading; and

“(B) in the development of subgrant application forms.

“SEC. 2508. STATE EVALUATIONS.

“(a) *IN GENERAL.*—Each reading and literacy partnership that receives a grant under this part shall reserve not more than 2 percent of such grant funds for the purpose of evaluating the success

of the partnership's subgrantees in meeting the purposes of this part. At a minimum, the evaluation shall measure the extent to which students who are the intended beneficiaries of the subgrants made by the partnership have improved their reading.

“(b) **CONTRACT.**—A reading and literacy partnership shall carry out the evaluation under this section by entering into a contract with an eligible research institution under which the institution will perform the evaluation.

“(c) **SUBMISSION.**—A reading and literacy partnership shall submit the findings from the evaluation under this section to the Secretary and the peer review panel convened under section 2503(f). The Secretary and the peer review panel shall submit a summary of the findings from the evaluations under this subsection to the appropriate committees of the Congress, including the Education and the Workforce Committee of the House of Representatives.

“SEC. 2509. PARTICIPATION OF CHILDREN ENROLLED IN PRIVATE SCHOOLS.

“Each reading and literacy partnership that receives funds under this part shall provide for, or ensure that subgrantees provide for, the participation of children in private schools in the activities and services assisted under this part in the same manner as the children participate in activities and services pursuant to sections 2503, 2504, 2505, and 2506.

“SEC. 2510. AUTHORIZATION OF APPROPRIATIONS; RESERVATIONS FROM APPROPRIATIONS; APPLICABILITY; SUNSET.

“(a) **AUTHORIZATION.**—There are authorized to be appropriated to carry out this part \$210,000,000 for fiscal years 1999, 2000, and 2001.

“(b) **RESERVATIONS.**—From the amount appropriated under subsection (a) for each fiscal year, the Secretary—

“(1) shall reserve 1.5 percent to carry out section 2506(a);

“(2) shall reserve \$5,075,000 to carry out sections 2503(f)(2) and 2507, of which \$5,000,000 shall be reserved for section 2507; and

“(3) shall reserve \$10,000,000 to carry out section 1202(c).

“(c) **APPLICABILITY.**—Part E shall not apply to this part.

“(d) **SUNSET.**—Notwithstanding section 422(a) of the General Education Provisions Act (20 U.S.C. 1226a(a)), this part is repealed, effective September 30, 2001, and is not subject to extension under such section.”.

Subtitle B—Amendments to Even Start Family Literacy Programs

SEC. 521. RESERVATION FOR GRANTS.

Section 1202(c) of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6362(c)) is amended to read as follows:

“(c) **RESERVATION FOR GRANTS.**—

“(1) **GRANTS AUTHORIZED.**—From funds reserved under section 2510(b)(3), the Secretary shall award grants, on a competitive basis, to States to enable such States to plan and implement, statewide family literacy initiatives to coordinate and integrate existing Federal, State, and local literacy resources con-

sistent with the purposes of this part. Such coordination and integration shall include coordination and integration of funds available under the Adult Education Act (20 U.S.C. 1201 et seq.), Head Start (42 U.S.C. 9801 et seq.), this part, part A of this title, and part A of title IV of the Social Security Act.

“(2) CONSORTIA.—

“(A) ESTABLISHMENT.—To receive a grant under this subsection, a State shall establish a consortium of State-level programs under the following laws:

“(i) This title.

“(ii) The Head Start Act.

“(iii) The Adult Education Act.

“(iv) All other State-funded preschool programs and programs providing literacy services to adults.

“(B) PLAN.—To receive a grant under this subsection, the consortium established by a State shall create a plan to use a portion of the State’s resources, derived from the programs referred to in subparagraph (A), to strengthen and expand family literacy services in such State.

“(C) COORDINATION WITH TITLE II.—The consortium shall coordinate its activities with the activities of the reading and literacy partnership for the State established under section 2503, if the State receives a grant under such section.

“(3) READING INSTRUCTION.—Statewide family literacy initiatives implemented under this subsection shall base reading instruction on reliable, replicable research on reading (as such terms are defined in section 2502).

“(4) TECHNICAL ASSISTANCE.—The Secretary shall provide, directly or through a grant or contract with an organization with experience in the development and operation of successful family literacy services, technical assistance to States receiving a grant under this subsection.

“(5) MATCHING REQUIREMENT.—The Secretary shall not make a grant to a State under this subsection unless the State agrees that, with respect to the costs to be incurred by the eligible consortium in carrying out the activities for which the grant was awarded, the State will make available non-Federal contributions in an amount equal to not less than the Federal funds provided under the grant.”.

SEC. 522. DEFINITIONS.

Section 1202(e) of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6362(e)) is amended—

(1) by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively; and

(2) by inserting after paragraph (2) the following:

“(3) the term ‘family literacy services’ means services provided to participants on a voluntary basis that are of sufficient intensity in terms of hours, and of sufficient duration, to make sustainable changes in a family (such as eliminating or reducing welfare dependency) and that integrate all of the following activities:

“(A) Interactive literacy activities between parents and their children.

“(B) Equipping parents to partner with their children in learning.

“(C) Parent literacy training, including training that contributes to economic self-sufficiency.

“(D) Appropriate instruction for children of parents receiving parent literacy services.”.

SEC. 523. EVALUATION.

Section 1209 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6369) is amended—

(1) in paragraph (1), by striking “and” at the end;

(2) in paragraph (2), by striking the period at the end and inserting “; and”; and

(3) by adding at the end the following:

“(3) to provide States and eligible entities receiving a subgrant under this part, directly or through a grant or contract with an organization with experience in the development and operation of successful family literacy services, technical assistance to ensure local evaluations undertaken under section 1205(10) provide accurate information on the effectiveness of programs assisted under this part.”.

SEC. 524. INDICATORS OF PROGRAM QUALITY.

(a) IN GENERAL.—The Elementary and Secondary Education Act of 1965 (20 U.S.C. 6301 et seq.) is amended—

(1) by redesignating section 1210 as section 1212; and

(2) by inserting after section 1209 the following:

“SEC. 1210. INDICATORS OF PROGRAM QUALITY.

“Each State receiving funds under this part shall develop, based on the best available research and evaluation data, indicators of program quality for programs assisted under this part. Such indicators shall be used to monitor, evaluate, and improve such programs within the State. Such indicators shall include the following:

“(1) With respect to eligible participants in a program who are adults—

“(A) achievement in the areas of reading, writing, English language acquisition, problem solving, and numeracy;

“(B) receipt of a secondary school diploma or its recognized equivalent;

“(C) entry into a postsecondary school, a job retraining program, or employment or career advancement, including the military; and

“(D) such other indicators as the State may develop.

“(2) With respect to eligible participants in a program who are children—

“(A) improvement in ability to read on grade level or reading readiness;

“(B) school attendance;

“(C) grade retention and promotion; and

“(D) such other indicators as the State may develop.”.

(b) STATE LEVEL ACTIVITIES.—Section 1203(a) of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6363(a)) is amended—

(1) in paragraph (1), by striking “and” at the end;

(2) in paragraph (2), by striking the period at the end and inserting “; and”; and

(3) by adding at the end the following:

“(3) carrying out section 1210.”.

(c) **AWARD OF SUBGRANTS.**—Paragraphs (3) and (4) of section 1208(b) of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6368) are amended to read as follows:

“(3) **CONTINUING ELIGIBILITY.**—In awarding subgrant funds to continue a program under this part for the second, third, or fourth year, the State educational agency shall evaluate the program based on the indicators of program quality developed by the State under section 1210. Such evaluation shall take place after the conclusion of the startup period, if any.

“(4) **INSUFFICIENT PROGRESS.**—The State educational agency may refuse to award subgrant funds if such agency finds that the eligible entity has not sufficiently improved the performance of the program, as evaluated based on the indicators of program quality developed by the State under section 1210, after—

“(A) providing technical assistance to the eligible entity;

and

“(B) affording the eligible entity notice and an opportunity for a hearing.”.

SEC. 525. RESEARCH.

The Elementary and Secondary Education Act of 1965 (20 U.S.C. 6301 et seq.) is amended further by inserting after section 1210 (as inserted by section 524(a)(2) of this Act) the following:

“SEC. 1211. RESEARCH.

“(a) **IN GENERAL.**—The Secretary shall carry out, through grant or contract, research into the components of successful family literacy services. The purpose of the research shall be—

“(1) to improve the quality of existing programs assisted under this part or other family literacy programs carried out under this Act or the Adult Education Act (20 U.S.C. 1201 et seq.); and

“(2) to develop models for new programs to be carried out under this Act or the Adult Education Act.

“(b) **DISSEMINATION.**—The National Institute for Literacy shall disseminate, pursuant to section 2507, the results of the research described in subsection (a) to States and recipients of subgrants under this part.”.

TITLE VI—MISCELLANEOUS PROVISIONS

SEC. 601. MULTILINGUALISM STUDY.

(a) **FINDINGS.**—Congress finds that—

(1) even though all residents of the United States should be proficient in English, without regard to their country of birth, it is also of vital importance to the competitiveness of the United States that those residents be encouraged to learn other languages; and

(2) education is the primary responsibility of State and local governments and communities, and these entities are responsible for developing policies in this subject area.

(b) *RESIDENT OF THE UNITED STATES DEFINED.*—In this section, the term “resident of the United States” means an individual who resides in the United States, other than an alien who is not lawfully present in the United States.

(c) *STUDY.*—

(1) *IN GENERAL.*—Not later than 180 days after the date of enactment of this Act, the Comptroller General of the United States (referred to in this section as the “Comptroller General”) shall conduct a study of multilingualism in the United States in accordance with this section.

(2) *REQUIREMENTS.*—

(A) *IN GENERAL.*—The study conducted under this section shall ascertain—

(i) the percentage of residents in the United States who are proficient in English and at least 1 other language;

(ii) the predominant language other than English in which residents referred to in clause (i) are proficient;

(iii) the percentage of the residents described in clause (i) who were born in a foreign country;

(iv) the percentage of the residents described in clause (i) who were born in the United States;

(v) the percentage of the residents described in clause (iv) who are second-generation residents of the United States; and

(vi) the percentage of the residents described in clause (iv) who are third-generation residents of the United States.

(B) *AGE-SPECIFIC CATEGORIES.*—The study under this section shall, with respect to the residents described in subparagraph (A)(i), determine the number of those residents in each of the following categories:

(i) Residents who have not attained the age of 12.

(ii) Residents who have attained the age of 12, but have not attained the age of 18.

(iii) Residents who have attained the age of 18, but have not attained the age of 50.

(iv) Residents who have attained the age of 50.

(C) *FEDERAL PROGRAMS.*—In conducting the study under this section, the Comptroller General shall establish a list of each Federal program that encourages multilingualism with respect to any category of residents described in subparagraph (B).

(D) *COMPARISONS.*—In conducting the study under this section, the Comptroller General shall compare the multilingual population described in subparagraph (A) with the multilingual populations of foreign countries—

(i) in the Western hemisphere; and

(ii) in Asia.

(d) *REPORT*.—Upon completion of the study under this section, the Comptroller General shall prepare, and submit to Congress, a report that contains the results of the study conducted under this section, and such findings and recommendations as the Comptroller General determines to be appropriate.

SEC. 602. SAFER SCHOOLS.

(a) *SHORT TITLE*.—This section may be cited as the “Safer Schools Act of 1998”.

(b) *AMENDMENT*.—Section 14601 of the Gun-Free Schools Act of 1994 (20 U.S.C. 8921) is amended by adding at the end the following new subsection:

“(g) For the purposes of this section, a weapon that has been determined to have been brought to a school by a student shall be admissible as evidence in any internal school disciplinary proceeding (related to an expulsion under this section).”.

SEC. 603. STUDENT IMPROVEMENT INCENTIVE AWARDS.

Section 6201 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 7331) is amended—

(1) in subsection (a)—

(A) in paragraph (1)(C), by striking “and” after the semicolon;

(B) in paragraph (2), by striking the period and inserting “; and”; and

(C) by adding at the end the following:

“(3) student improvement incentive awards described in subsection (c).”; and

(2) by adding at the end the following:

“(c) **STUDENT IMPROVEMENT INCENTIVE AWARDS**.—

“(1) **AWARDS**.—A State educational agency may use funds made available for State use under this title to make awards to public schools in the State that are determined to be outstanding schools pursuant to a statewide assessment described in paragraph (2).

“(2) **STATEWIDE ASSESSMENT**.—The statewide assessment referred to in paragraph (1)—

“(A) shall—

“(i) determine the educational progress of students attending public schools within the State; and

“(ii) allow for an objective analysis of the assessment on a school-by-school basis; and

“(B) may involve exit exams.”.

And the Senate agree to the same.

WILLIAM ARCHER,
BILL GOODLING,
DICK ARMEY,

Managers on the Part of the House.

WILLIAM V. ROTH,
CONNIE MACK,
DAN COATS,
SLADE GORTON,
PAUL COVERDELL,

Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to 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, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report.

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I. REVENUE PROVISIONS

A. Modifications to Education Individual Retirement Accounts (IRAs) (sec. 2 of the House bill and sec. 101 of the Senate amendment)

Present Law

In general.—Section 530 provides tax-exempt status to “education IRAs,” meaning certain trusts (or custodial accounts) which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a named beneficiary.¹ Contributions to education IRAs may be made only in cash. Annual contributions to education IRAs may not exceed \$500 per designated beneficiary (except in cases involving certain tax-free rollovers, as described below), and may not be made after the designated beneficiary reaches age 18.² Moreover, section 4973 imposes a penalty excise tax if a contribution is made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary. These provisions were enacted as part of the Taxpayer Relief Act of 1997 (“1997 Act”).

Phase-out of contribution limit.—The \$500 annual contribution limit for education IRAs is phased out ratably for contributors with modified AGI between \$95,000 and \$110,000 (\$150,000 and \$160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any other individual.

Treatment of distributions.—Amounts distributed from education IRAs are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of the designated beneficiary incurred during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed under sec. 25A with respect to the beneficiary for the same taxable year).³ If a HOPE credit or Lifetime Learning credit is claimed with respect to a student for a taxable year, then a distribution from an education IRA may (at the option of the taxpayer) be made during that taxable year on behalf of that student, but an exclusion is *not* available under the Act for the earnings portion of such distribution.⁴

¹ Education IRAs generally are not subject to Federal income tax, but are subject to the unrelated business income tax (“UBIT”) imposed by section 511.

² An excise tax penalty may be imposed under present-law section 4973 to the extent that excess contributions above the \$500 annual limit are made to an education IRA.

³ The exclusion will not be a preference item for alternative minimum tax (AMT) purposes.

⁴ If a HOPE credit or Lifetime Learning credit was claimed with respect to a student for an earlier taxable year, the exclusion provided for by section 530 may be claimed with respect to the same student for a *subsequent* taxable year with respect to a distribution from an education IRA made in that subsequent taxable year in order to cover qualified higher education expenses

Distributions from an education IRA generally are deemed to consist of distributions of principal (which, under all circumstances, are excludable from gross income) and earnings (which may be excludable from gross income) by applying the ratio that the aggregate amount of contributions to the account for the beneficiary bears to the total balance of the account. If the qualified higher education expenses of the student for the year are at least equal to the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the earnings in their entirety will be excludable from gross income. If, on the other hand, the qualified higher education expenses of the student for the year are *less than* the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the qualified higher education expenses will be deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings will be excludable under section 530 (i.e., a portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings will be includible in the distributee's gross income.⁵ To the extent that a distribution exceeds qualified higher education expenses of the designated beneficiary, an additional 10-percent tax is imposed on the earnings portion of such excess distribution under section 530(d)(4), unless such distribution is made on account of the death or disability of, or scholarship received by, the designated beneficiary.

Section 530(d) allows tax-free (and penalty-free) transfers or rollovers of account balances from one education IRA benefitting one beneficiary to another education IRA benefitting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.⁶

The legislative history to the 1997 Act indicates that any balance remaining in an education IRA will be deemed to be distrib-

incurring during that year. Conversely, if an exclusion is claimed for a distribution from an education IRA with respect to a particular student, then a HOPE credit or Lifetime Learning credit will be available in a subsequent taxable year with respect to that same student (provided that no exclusion is claimed in such other taxable years for distributions from an education IRA on behalf of that student and provided that the requirements of the HOPE credit or Lifetime Learning credit are satisfied in the subsequent taxable year).

⁵For 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 excludable 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.

⁶For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons.

uted within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses.—The term “qualified higher education expenses” includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. Moreover, the term “qualified higher education expenses” include room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, section 530(b)(2)(B) specifically provides that qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee’s gross income under section 127. In addition, qualified higher education expenses do not include expenses paid with amounts that are excludable under section 135. No reduction of qualified higher education expenses is required, however, for a gift, bequest, devise, or inheritance within the meaning of section 102(a).

Eligible educational institution.—Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor’s degree, an associate’s degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

House Bill

Annual contribution limit.—For the period 1998 through 2002, the House bill increases to \$2,500 the annual contribution limit that currently applies to education IRAs under section 530(b)(1)(A)(iii). Thus, under the House bill, aggregate contributions that may be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary are limited to \$2,500 for each year during the period 1998 through

2002. For 2003 and later years, the annual contribution limit for education IRAs is \$500.

Qualified expenses.—With respect to contributions made during the period 1998 through 2002 (and earnings attributable to such contributions), the House 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 (1) 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 at a public, private, or religious school (through grade 12). “Qualified elementary and secondary education expenses” also include certain homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling. For contributions made in 2003 or later years (and for earnings attributable to such contributions), the definition of qualified education expenses is limited to post-secondary education expenses.

Special needs beneficiaries.—The House 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). In addition, 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.

Contributions by persons other than individuals.—The House bill clarifies that corporations and other entities (e.g., tax-exempt entities) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution. As under present law, the eligibility of high-income *individuals* to make contributions to education IRAs is phased out ratably for individuals with modified AGI between \$95,000 and \$110,000 (\$150,000 and \$160,000 for joint returns).

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

Senate Amendment

Annual contribution limit.—The Senate amendment is the same as the House bill, except that the Senate amendment increases to \$2,000 the annual contribution limit, and only for the period 1999 through 2002.

Qualified expenses.—With respect to contributions made during the period 1999 through 2002 (and earnings attributable to such contributions), the Senate amendment 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 (1) tuition,

fees, academic tutoring⁷, special needs services, books, supplies, and equipment (including computers and related software and services) incurred *in connection with* the enrollment or attendance of the designated beneficiary as an elementary or secondary student at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12), *and* (2) room and board, uniforms, transportation, and supplementary items and services (including extended-day programs) *required or provided by* such a school in connection with such enrollment or attendance of the designated beneficiary. “Qualified elementary and secondary education expenses” also include certain homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling. For contributions made in 2003 or later years (and for earnings attributable to such contributions), the definition of qualified education expenses is limited to post-secondary education expenses.⁸

Under the Senate amendment, no deduction or credit (such as the dependent care credit under section 21) will be allowed under the Internal Revenue Code for any qualified education expenses taken into account in determining the amount of the exclusion under section 530 for a distribution from an education IRA.

With respect to post-secondary education, qualified education expenses include (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred in connection with the enrollment or attendance of the designated beneficiary at an eligible post-secondary educational institution, and (2) room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution calculating costs of attendance for Federal financial aid programs) for any period during which the student is at least a half-time student.

Special needs beneficiaries.—The Senate amendment is the same as the House bill.⁹

Contributions by persons other than individuals.—The Senate amendment is the same as the House bill.

Technical corrections.—The Senate amendment provides for several technical corrections to section 530 (as enacted as part of the Taxpayer Relief Act of 1997), including: (1) adding a provision 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; (2) clarifying that, under rules contained in present-law section 72, distributions from education IRAs are treat-

⁷For this purpose, the Senate amendment provides that it is intended that “academic tutoring” means additional, personalized instruction provided in coordination with the student’s academic courses.

⁸To the extent a taxpayer incurs “qualified elementary and secondary expenses” during any year that a distribution is made from an education IRA, the distribution will be deemed to first consist of a distribution of any contributions (and earnings thereon) that were made to the education IRA during the period 1999-2002 (reduced by the amount of such contributions and earnings that were deemed to be distributed in prior taxable years). The Senate amendment requires that trustees of education IRAs keep separate accounts with respect to contributions made during the period 1999-2002 (and earnings thereon).

⁹The legislative history to the Senate amendment clarifies the Committee’s intention that the determination of whether a beneficiary has “special needs” will be required to be made for each year that contributions are made to an education IRA after the beneficiary reaches age 18. However, if an individual meets the definition of a “special needs” beneficiary when such individual reaches age 30, then such individual thereafter will be presumed to be a “special needs” beneficiary.

ed as representing a pro-rata share of the principal and accumulated earnings in the account; and (3) clarifying that, under section 530(d)(4), the 10-percent additional tax will not be imposed in cases where a distribution (although used to pay for qualified higher education expenses) is includible in gross income solely because the taxpayer elects the HOPE or Lifetime Learning credit on behalf of the student for the same taxable year.

Effective date.—The provisions modifying education IRAs under section 530 generally are effective for taxable years beginning after December 31, 1998. However, the provision that increases the annual contribution limit for education IRAs (i.e., to \$2,000 per year) applies during the period January 1, 1999, through December 31, 2002, and the provision that expands the definition of qualified education expenses to include qualified elementary and secondary education expenses applies to contributions (and earnings thereon) made during the period January 1, 1999, through December 31, 2002. The technical correction provisions are effective as if included in the 1997 Act—i.e., for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment and includes certain additional technical corrections.

The conference agreement clarifies that, in the event of the death of the designated beneficiary, the balance remaining in an education IRA may be distributed (without imposition of the additional 10-percent tax) to any other (i.e., contingent) beneficiary or to the estate of the deceased designated beneficiary. If any member of the family of the deceased beneficiary becomes the new designated beneficiary of an education IRA, then no tax will be imposed on such redesignation and the account will continue to be treated as an education IRA.

The conference agreement further provides 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). In addition, the conference agreement amends section 4973(e) to provide that the excise tax penalty applies under that section for each year that an excess contribution remains in an education IRA (and not merely the year that the excess contribution is made).

The conference agreement clarifies that, in order for taxpayers to establish an education IRA, the designated beneficiary must be a life-in-being. Further, the conference agreement clarifies that for purposes of the special rules regarding tax-free rollovers and changes of designated beneficiaries, the new beneficiary must be under the age of 30.

The conference agreement also provides that, if any qualified higher education expenses are taken into account in determining the amount of the exclusion under section 530 for a distribution

from an education IRA, then no deduction (under section 162 or any other section), or exclusion (under section 135) or credit will be allowed under the Internal Revenue Code with respect to such qualified higher education expenses.

In addition, because the 1997 Act allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under present-law section 135 (as if the proceeds were used to pay qualified higher education expenses) provided the proceeds from the redemption are contributed to an education IRA (or to a qualified State tuition program defined under section 529) on behalf of the taxpayer, the taxpayer's spouse, or a dependent, the conference agreement conforms the definition of "eligible educational institution" under section 135 to the broader definition of that term under present-law section 530 (and section 529). Thus, for purposes of section 135, as under present-law sections 529 and 530, the term "eligible educational institution" is defined as an institution which (1) is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) and (2) is eligible to participate in Department of Education student aid programs.

B. Exclusion From Gross Income of Education Distributions From Qualified Tuition Programs (sec. 104 of the Senate amendment)

Present Law

Section 529 provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. The term "qualified higher education expenses" has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution,¹⁰ as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.

Section 529 also provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the

¹⁰"Eligible educational institutions" are defined the same for purposes of education IRAs (described in I.A., above) and qualified State tuition programs.

extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor or another distributee (e.g., when a parent receives a refund) will be included in the contributor's/distributee's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.¹¹ Contributors and beneficiaries are not allowed to directly or indirectly direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefitting one designated beneficiary to another account benefitting a different beneficiary will be considered a distribution (as will a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family.¹² Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

No amount is includible in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any contribution to or earnings on such a program until a distribution is made from the program, at which time the earnings portion of the distribution (whether made in cash or in-kind) will be includible in the gross income of the distributee. However, to the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f)(1)), the distributee (or another taxpayer claiming the distributee as a dependent) will be able to claim the HOPE credit or Lifetime Learning credit under section 25A with respect to such tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phaseout for those credits does not apply).

¹¹ Sections 529(c)(2), (c)(4), and (c)(5), and section 530(d)(3) provide special estate and gift tax rules for contributions made to, and distributions made from, qualified State tuition programs and education IRAs.

¹² For this purpose, the term "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, an exclusion from gross income is provided for distributions from qualified State tuition programs (as defined in sec. 529) to the extent that the distribution is used to pay for (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred *in connection with* the enrollment or attendance of a designated beneficiary at an eligible post-secondary educational institution (i.e., colleges, universities, and certain vocational schools), *and* (2) room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution calculating costs of attendance for Federal financial aid programs) for any period during which the student is at least a half-time student. As under present law, there is no specific dollar limitation imposed under the Internal Revenue Code on contributions made to qualified State tuition programs, although section 529(b)(7) will continue to require that the programs themselves provide adequate safeguards to prevent contributions on behalf of a beneficiary in excess of those necessary to provide for qualified higher education expenses of the beneficiary.

As with the present-law exclusion from gross income for distributions from education IRAs, the tax-free treatment for a distribution from a qualified State tuition program will be allowed only if, for the taxable year during which the distribution is made, a HOPE or Lifetime Learning credit (under sec. 25A) is not claimed on behalf of the student. As under present law, if a student is claimed as a dependent by his or her parent, then the parent (if eligible) must decide whether to elect to claim a HOPE or Lifetime Learning credit with respect to that student for that taxable year; and, if the parent elects to claim a HOPE or Lifetime Learning credit, then the earnings portion of a distribution made to a student from a qualified State tuition program will be includible in the gross income of the student.

Under the Senate amendment, no deduction (under section 162 or any other section) or credit is allowed under the Internal Revenue Code for any qualified higher education expenses taken into account in determining the amount of the exclusion under section 529 for a distribution made to, or on behalf of, a student by a qualified State tuition program.

Technical correction.—The Senate amendment clarifies that, under rules contained in present-law section 72, distributions from qualified State tuition programs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account.

Effective date.—The provision that allows an exclusion from gross income for certain distributions from qualified State tuition programs under section 529 (and the modification to the definition of qualified higher education expenses under that section) is effec-

tive for distributions made in taxable years beginning after December 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment, except that it expands the definition of “qualified tuition program” to include not only qualified State tuition programs as defined under present-law section 529, but also certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private educational institutions, persons may purchase tuition credits or certificates on behalf of a designated beneficiary as set forth in section 529(b)(1)(A)(i), but may not make contributions to an account as described in section 529(b)(1)(A)(ii) (so-called “savings account plans”). In addition, contributions to any such program on behalf of a named beneficiary may not exceed \$5,000 per year, with an aggregate limit of \$50,000 for contributions to all such programs on behalf of that beneficiary for all years.¹³ Contributions may not be made to a qualified tuition program maintained by one or more private educational institutions in any year in which contributions are made on behalf of the same beneficiary to an education IRA or a State-sponsored qualified tuition program.

In addition, the conference agreement includes a technical correction to section 529(e)(2), clarifying that—for purposes of tax-free rollovers and changes of designated beneficiaries—a “member of the family” includes the spouse of the original beneficiary.

Effective date.—The provision providing for the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 2005. The technical corrections provision is effective for distributions made after December 31, 1997.

C. Extension of Exclusion for Employer-Provided Education Assistance (sec. 105 of the Senate amendment)

Present Law

Under present-law section 127, an employee’s gross income and wages do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts are paid or incurred pursuant to an educational assistance program that meets certain requirements. This exclusion is limited to \$5,250 of educational assistance with respect to an individual during a cal-

¹³To the extent contributions exceed the \$50,000 aggregate limit, an excise tax penalty may be imposed under present-law section 4973, unless the excess contributions (and any earnings thereon) are returned to the contributor before the due date for the return for the taxable year during which the excess contribution is made.

State-sponsored qualified tuition programs will continue to be governed by the rule contained in present-law section 529(b)(7) that such programs provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. State-sponsored qualified tuition programs will not be subject to a specific dollar cap under section 529 on annual (or aggregate) contributions that can be made under the program on behalf of a named beneficiary.

endar year. The exclusion does not apply with respect to graduate-level courses. The exclusion is scheduled to expire with respect to courses beginning after May 31, 2000.

In the absence of the exclusion provided by section 127, educational assistance is excludable from income only if the education is related to the employee's current job, meaning that the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (but not if the education relates to certain minimum educational requirements or enables a taxpayer to begin working in a new trade or business).

House Bill

No provision.

Senate Amendment

The Senate amendment reinstates the exclusion for graduate-level courses, effective with respect to courses beginning after December 31, 1997. In addition, the Senate amendment provides that the exclusion (as applied to both graduate and undergraduate courses) expires with respect to courses beginning after December 31, 2002.

Effective date.—The extension of the exclusion for employer-provided educational assistance to graduate-level courses is effective for expenses with respect to courses beginning after December 31, 1997. The exclusion (with respect to both graduate and undergraduate courses) expires with respect to courses beginning after December 31, 2002.

Conference Agreement

The conference agreement follows the Senate amendment, except that it does not reinstate the exclusion for graduate-level courses.

D. Arbitrage Rebate Exception for Governmental Bonds of Certain Small Governments (sec. 106 of the Senate amendment)

Present Law

Arbitrage profits earned on tax-exempt bonds generally must be rebated to the Federal Government. An exception is provided for profits earned on governmental bonds issued by certain governmental units that issue no more than \$5 million of such bonds in the year when the bonds benefitting from the exception are issued. The \$5 million limit is increased to \$10 million if bonds equal to at least the excess over \$5 million are used to finance public schools.

House Bill

No provision.

Senate Amendment

The Senate amendment allows an additional \$5 million of public school bonds to be issued without loss of eligibility for the small-issuer arbitrage rebate exception (for total issuance of up to \$15 million per year if bonds equal to at least the excess over \$5 million are used to finance public schools).

Effective date.—The provision is effective for bonds issued after December 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment.

E. Exclusion of Certain Amounts Received Under the National Health Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (sec. 107 of the Senate amendment)

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.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, 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—are 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. As with other qualified scholarships under section 117, the tax-free treatment does not

apply to amounts received by students to cover regular living expenses, such as room and board.

Effective date.—The provision applies to amounts received in taxable years beginning after December 31, 1993.

Conference Agreement

The conference agreement follows the Senate amendment. In addition, the conference agreement provides that amounts received by an individual under the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program under subchapter I of chapter 105 of title 10 U.S.C. also are eligible for tax-free treatment as a qualified scholarship under section 117, without regard to the recipient's future service obligation.

F. Tax-Exempt Bonds for Privately Owned Public Schools (sec. 108 of the Senate amendment)

Present Law

Interest on State and local government bonds generally is tax-exempt if the bond proceeds are used to carry out governmental functions of the issuer and the debt is repaid with governmental funds. Interest on bonds used to finance private business activities is taxable unless the Internal Revenue Code includes an exception for the activity involved. The Code does not include an exception for bonds to finance public schools owned by for-profit private businesses.

House Bill

No provision.

Senate Amendment

The Senate amendment allows States to issue up to \$10 per resident (\$5 million, if greater) per year in tax-exempt bonds for public schools that are owned by for-profit, private businesses, but that are operated by States or local governments as part of the public school system. Except for an amount not exceeding \$5 million per year, each State could use these bonds only for public elementary and secondary schools located in "high-growth" school districts. High-growth school districts are defined as districts having an enrollment of at least 5,000 students in the second preceding academic year and having experienced student enrollment increases of 20 percent or more during the 5-year period ending with that second year.

Effective date.—The provision is effective for bonds issued after December 31, 1998.

Conference Agreement

The conference agreement does not include the Senate amendment.

**G. Employer Deductions for Vacation and Severance Pay
(sec. 3(a) of the House bill and sec. 201 of the Senate
amendment)**

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 of the employee. 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.¹⁴ 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.

¹⁴ While the rules of section 83 may govern the income inclusion, section 404 governs the deduction if the amount involved is deferred compensation.

House Bill

The House bill specifically overrules the result in *Schmidt Baking* and provides that the Internal Revenue Code will be applied without regard to the result reached in that case. Thus, under the House bill, the fact that an item of compensation is includible in income is not taken into account in determining whether or not payment has been made. Thus, an item of compensation must have been actually paid or received by employees 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, the provision is not limited to such items of compensation. In addition, arrangements similar to the letter of credit approach used in *Schmidt Baking* do not constitute actual receipt by the employee.

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. Any adjustment required by section 481 as a result of the change is taken into account in the year of the change.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment does not apply to severance pay. In addition, the Senate amendment makes certain technical modifications. Instead of providing that the Code is to be applied without regard to the result in *Schmidt Baking*, the Senate amendment explicitly provides that for purposes of determining whether an item of compensation (other than severance pay) is deferred compensation, the compensation is not considered to be paid or received until actually received by the employee. As under the House bill, similar arrangements to the letter of credit approach used in *Schmidt Baking* do not constitute actual receipt by the employee.

Effective date.—The provision is effective for taxable years ending after the date of enactment. With respect to the change in method of accounting, the Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill, with certain technical modifications as incorporated in the Senate amendment.

As under the House bill and Senate amendment, the fact that an item of compensation is includible in employees' incomes or wages within the applicable 2½ month period is not relevant to determining whether an item of compensation is deferred compensation.

As under the House bill and Senate amendment, many arrangements in addition to the letter of credit approach used in *Schmidt Baking* do not constitute actual receipt by employees. For example, actual receipt 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, actual receipt 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, actual receipt does not include an amount transferred as a loan, refundable deposit, or contingent payment. Further, amounts set aside in a trust for employees are not considered to be actually received by the employee.

Effective date.—The provision is effective for taxable years ending after December 31, 2001. Under the conference agreement, for the first taxable year for which the provision is effective, a taxpayer is permitted to calculate estimated tax liability by taking into account only 60 percent of the estimated tax payments otherwise required to be made on account of the provision.

H. Modification to Foreign Tax Credit Carryback and Carryover Periods (sec. 202 of the Senate amendment)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate foreign tax credit limitations are applied to specific categories of income.

The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and forward five years. The amount carried over may be used as a credit in a carryover year to the extent the taxpayer otherwise has excess foreign tax credit limitation for such year. The separate foreign tax credit limitations apply for purposes of the carryover rules.

House Bill

No provision.

Senate Amendment

The Senate amendment reduces the carryback period for excess foreign tax credits from two years to one year. The amendment also extends the excess foreign tax credit carryforward period from five years to seven years.

Effective date.—The provision applies to foreign tax credits arising in taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment.

I. Limited Tax Benefits in the Revenue Title Subject to the Line Item Veto Act

Present Law

The Line Item Veto Act amended the Congressional Budget and Impoundment Act of 1974 to grant the President the limited authority to cancel specific dollar amounts of discretionary budget authority, certain new direct spending, and limited tax benefits. The Line Item Veto Act provides that the Joint Committee on Taxation is required to examine any revenue or reconciliation bill or joint resolution that amends the Internal Revenue Code of 1986 prior to its filing by a conference committee in order to determine whether or not the bill or joint resolution contains any “limited tax benefits,” and to provide a statement to the conference committee that either (1) identifies each limited tax benefit contained in the bill or resolution, or (2) states that the bill or resolution contains no limited tax benefits. The conferees determine whether or not to include the Joint Committee on Taxation statement in the conference report. If the conference report includes the information from the Joint Committee on Taxation identifying provisions that are limited tax benefits, then the President may cancel one or more of those, but only those, provisions that have been identified. If such a conference report contains a statement from the Joint Committee on Taxation that none of the provisions in the conference report are limited tax benefits, then the President has no authority to cancel any of the specific tax provisions, because there are no tax provisions that are eligible for cancellation under the Line Item Veto Act. If the conference report contains no statement with respect to limited tax benefits, then the President may cancel any revenue provision in the conference report that he determines to be a limited tax benefit.

Conference Statement

The Joint Committee on Taxation has determined that the revenue title to H.R. 2646 contains the following provision that constitutes a limited tax benefit within the meaning of the Line Item Veto Act:

Section 104 (relating to additional increase in arbitrage rebate exception for governmental bonds used to finance education facilities).

II. NON-TAX PROVISIONS

A. Prohibition on Federal Testing

House Bill

No provision.

Senate Amendment

Section 102 of Title I of the Senate amendment prohibits Federally-sponsored testing unless specifically and explicitly provided for in authorizing legislation enacted into law.

Conference Agreement

Senate recesses.

B. Student Improvement Incentive Awards

House Bill

No provision.

Senate Amendment

Section 103 of Title I of the Senate amendment authorizes student improvement incentive awards which could be used by a State educational agency to make awards to public schools in the State that are determined to be outstanding schools pursuant to a state-wide assessment.

Conference Agreement

House recesses.

C. State Incentives for Teacher Testing and Merit Pay

House Bill

No provision.

Senate Amendment

Section 301 of Title III of the Senate amendment authorizes incentives for states to implement teacher testing and merit pay programs. The Department of Education would provide awards to states that test their K-12 teachers every 3-5 years in the subjects they teach and that have a merit pay program.

Conference Agreement

House recesses.

D. Equal Educational Opportunity

House Bill

No provision.

Senate Amendment

Section 401 of Title IV of the Senate amendment authorizes the use of Federal education dollars to fund education reform projects that provide same gender schools and classrooms, as long as comparable educational opportunities are offered for students of both sexes.

Conference Agreement

House recedes.

E. Education Block Grant

House Bill

No provision.

Senate Amendment

Sections 501–507 of Title V of the Senate amendment provide States a choice of receiving over \$10 billion in Federal education funds as a block grant at the state level, local level, or to continue receiving funding as under current categorical programs.

Conference Agreement

Senate recedes. The Conferees have reluctantly agreed to remove the education block grant amendment of Senator Slade Gorton (R-WA) from the conference report in order to expeditiously move the underlying education savings account measure to the President. The Conferees believe the Gorton amendment would have returned authority for decisions about our children's education to where it belongs—to our parents, teachers, principals, superintendents and elected school board members, not bureaucrats in Washington, DC. The Conferees wish to commend the diligent efforts of Senator Gorton in this matter.

F. Sense of the Senate on Dollars to the Classroom

House Bill

No provision.

Senate Amendment

Sections 601–602 of Title VI of the Senate amendment is a Sense of the Senate resolution that 95 percent of every Federal education dollar should end up in the classroom.

Conference Agreement

House recedes.

G. Reading Excellence***House Bill***

No provision.

Senate Amendment

Sections 701, 711, and 721–725 of Title VII of the Senate amendment authorize a literacy program which focuses upon training teachers to teach reading using scientifically proven methods, like phonics.

Conference Agreement

House recedes.

H. Drop-out Prevention Program***House Bill***

No provision.

Senate Amendment

Sections 801, 811–812, and 821 of Title VIII of the Senate amendment authorize a National Dropout Prevention program.

Conference Agreement

Senate recedes.

I. Multilingualism Study***House Bill***

No provision.

Senate Amendment

Section 901 of Title IX of the Senate amendment authorizes a study on multilingualism.

Conference Agreement

House recedes with an amendment to add a finding to indicate that education is the primary responsibility of State and local governments and as such they are responsible for developing policies on multilingualism.

J. Safe Schools***House Bill***

No provision.

Senate Amendment

Section 902 of Title IX of the Senate amendment provides that weapons brought to school are admissible as evidence in any internal school disciplinary proceeding.

Conference Agreement

House recesses.

WILLIAM ARCHER,
BILL GOODLING,
DICK ARMEY,
Managers on the Part of the House.

WILLIAM V. ROTH,
CONNIE MACK,
DAN COATS,
SLADE GORTON,
PAUL COVERDELL,
Managers on the Part of the Senate.

