[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS
(S. 230, S. 450, S. 644, S. 978, AND S. 1039)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON MAY 22, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

MAY 20, 1981

U.S. GOVERNMENT PRINTING OFFICE
78-298 O WASHINGTON : 1981 JCS-21-81

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I. SUMMARY

1. S. 230—Senator Matsunaga

Withholding of State Income Tax From Seamen's Wages on a Voluntary Basis

Under present law, employers must deduct and withhold Federal income and social security taxes from wages paid to employees (Code secs. 3402 and 3102). In general, employers are permitted (and may be required by State law) to deduct and withhold State income taxes. However, present law prohibits withholding of State taxes from wages of a seaman or fisherman (46 U.S. Code sec. 601), in order to prevent more than one State from requiring withholding in the case of a seaman or fisherman employed on a vessel operating between ports of more than one State. It is not clear under present law whether this prohibition extends to withholding that is voluntary as well as to that which is mandated by State income tax laws.

The bill would provide that a seaman or fisherman employed in the coastwise trade between ports of the same State may, after the date of enactment of the bill, enter into a voluntary agreement with employers for withholding from wages of amounts as State income taxes.

2. S. 450—Senator Matsunaga

Allowance of Investment Tax Credit for Work and Breeding Horses

Under present law, the ten-percent investment tax credit is available for livestock, other than horses, which is used in a trade or business or for income production and which has a useful life of three years or more (Code sec. 48(a)(6)).

The bill would provide that horses held for working and breeding purposes (but not horses held for racing or show purposes) would be eligible, if otherwise qualifying, for the investment tax credit. The amount of cost for any one horse eligible for the investment tax credit would be limited to $100,000.

The provisions of the bill would apply in the case of horses acquired in taxable years beginning after the date of enactment of the bill.

3. S. 644—Senator Jepsen

Treatment of Certain Finance Companies as Personal Holding Companies

Under present law, a tax is imposed on the undistributed personal holding company income of a personal holding company (Code sec. 541). Generally, personal holding company income includes interest. A corporation actively engaged in a lending or finance business is exempt from this tax if the corporation has qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from its lending or finance business, plus five percent of such ordinary gross income from $500,000 to $1 million. The term "lending or finance business" is defined to include the business of making loans with maturities of no more than 60 months.

The bill would increase the 60-month limitation of present law to 144 months, and would amend the definition of a lending or finance business to include the business of making certain types of revolving credit loans. The bill also would amend the business expense test of present law to require a lending or finance business to have qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from the lending or finance business, plus five percent of such ordinary gross income in excess of $500,000. Thus, the $1 million ordinary gross income amount would be eliminated for purposes of applying the qualifying business expense test.

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

4. S. 978—Senators Danforth and Chiles

Modification of Certain Form W-2 Filing Requirements

Present law requires an employer which pays wages from which Federal income tax or FICA (social security) tax must be withheld to furnish each employee a statement listing, among other information, the amount of income tax and FICA wages paid and the amounts withheld as tax (Form W-2). Except in the case of certain employees whose employment terminates during the year, Form W-2 must be supplied to the employee not later than January 31 of the year following the year in which the wages are paid. In the case of an employee whose employment terminates before the end of the calendar year, Form W-2 must be supplied to the employee with the final payment of wages (Code sec. 6051(a)).

Under the bill, the employer of an employee whose employment terminates during the year would be required to furnish the employee with a Form W-2 no later than January 31 of the following year (the same time all other employees must be provided a W-2), unless the employee requests an early receipt. If a terminating employee makes a written request for early receipt of a Form W-2, the employer would be required to furnish the W-2 no later than 30 days after the written request is received (rather than with the last payment of wages).

The provisions of the bill would apply in the case of employees whose employment terminates after enactment of the bill.

5. S. 1039—Senator Packwood

Permanent Extension of Provisions for Qualified Group Legal Services Plans

Under present law (Code sec. 120), effective for 1977 through 1981, employer contributions to a qualified group legal services plan and the benefits provided to an employee under the plan are excluded from the employee's income. The employer generally is allowed a business expense deduction for contributions to the plan.

The bill would make permanent the provisions of present law relating to a qualified group legal services plan. The bill would be effective on enactment.

II. DESCRIPTION OF BILLS

1. S. 230—Senator Matsunaga

Withholding of State Income Tax from Seamen's Wages on a Voluntary Basis

Present law

Under present law, employers must deduct and withhold Federal income and social security taxes from wages paid to employees (Code secs. 3402 and 3102).[1] In general, employers are permitted (and may be required by State law) to deduct and withhold State income taxes. However, present law prohibits withholding from wages of a seaman or fisherman any amounts for taxes imposed by a State, including a territory, possession, commonwealth, or a subdivision thereof (46 U.S. Code sec. 601).

This prohibition prevents several States from requiring withholding on the wages of a seaman or fisherman, as could happen if the vessel on which the seaman or fisherman is employed regularly operates between ports in those States. The prohibition also applies in the case of seamen and fishermen employed on vessels operating exclusively between ports of the same State. It is not clear under present law whether this prohibition extends to withholding that is voluntary as well as to that which is mandated by State income tax laws.

Issue

The issue is whether seamen and fishermen should be permitted to enter into voluntary agreements with their employers for withholding of State income tax from their wages, and if so, whether this rule should apply only to seamen and fishermen employed on vessels operating between ports in the same State.

Explanation of the bill

The bill would provide that a seaman or fisherman employed in the coastwise trade between ports of the same State may enter into a voluntary agreement with employers for withholding from wages of amounts as State income taxes.

Effective date

The bill would permit seamen and fishermen to enter, after the date of enactment of the bill, into voluntary withholding agreements with employers for State income taxes.

Revenue effect

The bill would not have any effect on Federal budget receipts.

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[1] Wages paid to fishermen for services performed on a boat are not subject to withholding of Federal income or social security taxes if (1) the fishermen receive shares of the catch, the amounts of which are contingent on the boat's catch, and (2) the operating crew of each boat from which an individual receives a share normally consists of fewer than ten individuals (Code secs. 3401(a)(17) and 3121(b)(20)).

2. S. 450—Senator Matsunaga

Allowance of Investment Tax Credit for Work and Breeding Horses

Present law

When the investment tax credit was restored in 1971, the credit was made applicable to livestock other than horses (Code sec. 48(a) (6). To be eligible for credit, livestock must be used in a trade or business or for the production of income (i.e., be subject to depreciation) and have a useful life of three years or more. The exclusion of horses applies not only to horses used for sporting purposes (such as race horses and show horses), but also to horses held for working and breeding purposes.

Issue

The issue is whether horses held for working and breeding purposes should be eligible for the investment tax credit.

Explanation of the bill

Under the bill, horses held for working and breeding purposes (but not for racing or show purposes) would be eligible for the investment tax credit if otherwise meeting the requirements for the credit. The bill would limit to $100,000 the cost that could be considered in claiming an investment tax credit for any one horse. In the case of multiple taxpayers or partnerships acquiring one horse, the total cost taken into consideration by all of the owners or the partnership could not exceed $100,000.

Effective date

The provisions of the bill would apply in the case of horses acquired in taxable years beginning after the date of enactment of the bill.

Revenue effect

It is estimated that the bill would reduce budget receipts by $8 million in fiscal year 1982, $21 million in 1983, $23 million in 1984, $25 million in 1985, and $28 million in 1986.

Prior Congressional action

The Revenue Act of 1978, as reported by the Committee on Finance, included a provision similar to the present bill (S. Rep. 95–1263, 95th Cong.). That provision was deleted by the conference committee.

3. S. 644—Senator Jepsen

Treatment of Certain Finance Companies as Personal Holding Companies

Present law

In general

Code section 541 imposes a 70-percent tax on the undistributed personal holding company income of a personal holding company. This provision is intended to prevent individuals from avoiding the graduated individual tax rates (up to 70 percent under present law) by holding investments through corporations, which are subject to a maximum tax rate of 46 percent.

A corporation constitutes a personal holding company if 60 percent of its adjusted gross income is personal holding company income and if 50 percent of its stock is owned by five or fewer shareholders at any time during the last half of the taxable year. Personal holding company income generally is defined as interest, dividends, royalties, rents, and certain other types of passive investment income.

Exclusion for lending, finance companies

Certain types of corporations actively engaged in a trade or business which produces income that usually would be considered passive investment income are excluded from the personal holding company tax provisions. Among the corporations excluded from these provisions are lending or finance companies.

A corporation qualifies as a lending or finance company if 60 percent of its ordinary gross income is derived from the active and regular conduct of a lending or finance business and certain other requirements are satisfied. The term "lending or finance business" is defined, in part, to mean a business of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, which at the date of the loan or acquisition have a remaining maturity of no more than 60 months. An exception to the 60-month rule is provided for loans, notes, or obligations secured by a security interest in personal property where the security interest arose out of the sale of goods or services in the course of the borrower's or transferor's trade or business.

The personal holding company provisions also apply a business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business. Under this requirement, a corporation does not qualify as a lending or finance company exempt from the personal holding company provisions unless the sum of its business expenses directly allocable to its lending or finance business equals or exceeds 15 percent of the first $500,000 of its ordinary gross income derived from a lending or finance business plus five percent of such ordinary gross income from $500,000 to $1 million.

Issues

The issues are whether to broaden the exclusion from personal holding company status for lending or finance businesses to include the business of making revolving credit loans or loans with maximum maturities of 144 months, and whether to modify the business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business.

Explanation of the bill

The bill would modify both the 60-month maturity limitation and the business expense requirement of the lending or finance company exception to the personal holding company provisions.

Under the bill, the definition of a lending or finance business would be broadened to include the business of making loans with maturities up to 144 months and to include the business of making certain types of revolving credit loans. Revolving credit loans qualifying under the bill would be such loans made under an agreement which provides that the creditor will make loans or advances (not in excess of an agreed upon maximum amount) from time to time for the account of the debtor upon request and which provides that the debtor may repay the loan, advance, or installment obligation in full or in installments.

The bill also would modify the amount of business expenses required in determining whether a corporation with more than $1 million in ordinary gross income from a lending or finance business is a lending or finance company. Under the bill, a corporation would satisfy the business expense test only if its qualifying business expenses equal or exceed 15 percent of the first $500,000 of ordinary gross income derived from a lending or finance business, plus five percent of such ordinary gross income in excess of $500,000.

Effective date

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

Prior Congressional action

A similar provision was included in H.R. 7171 (96th Congress) as reported by the Finance Committee (Sen. Rep. 96-1032) and passed by the Senate on December 13, 1980. That provision was deleted by the House in agreeing to H.R. 7171 on December 13, 1980.

4. S. 978—Senators Danforth and Chiles

Modification of Certain Form W–2 Filing Requirements

Present law

Under present law, an employer which pays wages from which Fed-ral income tax or FICA (social security) tax must be withheld is equired to furnish each employee a statement which sets forth the ames of the employer and employee, the amount of wages subject o income tax withholding and the amount withheld, the amount of FICA wages and the FICA tax withheld, and the amount of any dvance payments of the earned income credit (Code sec. 6051(a)). copy of this statement must be filed with the Internal Revenue ervice (sec. 6051(d)).

Form W–2, prescribed by the Internal Revenue Service, is used y employers to satisfy this requirement. The W–2 statement is used y the employee in preparing the individual income tax return, and copy of the statement is attached to that return when filed.

The statement of earnings must be supplied to the employee not ater than January 31 of the calendar year following the year in which he wages are paid. In the case of an employee whose employment erminates before the end of the calendar year, present law requires hat the statement be supplied to the employee with the final payment f wages (Code sec. 6051(a)).

Under Treasury regulations (Reg. § 31.6051-1(d)(1)), an employer ay furnish Form W–2 to an employee whose employment terminates rior to the close of the calendar year at any time after the termination ut no later than January 31 of the following year. However, if an mployee whose employment terminates prior to the close of the cal-ndar year requests earlier receipt of a Form W–2, and if there is no easonable expectation on the part of the employer and employee of urther employment during the calendar year, then the regulations rovide that the employee must be given a Form W–2 on or before the ter of the 30th day after the request or the 30th day after the last lary payment. It is not clear whether there is a statutory basis for is approach in the regulations.

Issue

The issue is when an employer should be required to furnish Form –2 to a terminating employee.

Explanation of the bill

Under the bill, an employer would be permitted to defer furnishing e required statement of earnings to an employee whose employment rminates until not later than January 31 of the calendar year follow-g the year in which the last wages are paid. If the employee makes written request for earlier receipt of the statement, the bill would require the employer to furnish the statement within 30 days of the request.

Effective date

The provisions of the bill would apply in the case of employees whose employment terminates after the date of enactment of the bill.

Revenue effect

The bill would not have any effect on budget receipts.

Prior Congressional action

In the 96th Congress, the Senate Finance Committee reported a bill (H.R. 5829, sec. 225) which included provisions relating to deferral of furnishing W-2 statements to terminated employees (Sen. Rpt. 96-940). That bill also would have required the employer to provide written notice to a terminating employee of the requirement for earlier furnishing of the statement on written request from the employee. No further action was taken on H.R. 5829.

Earlier in the 96th Congress, the Finance Subcommittee on Taxation and Debt Management held a hearing on another bill (S. 2171), which contained provisions identical in substance to section 225 of H.R. 5829. No further action was taken on S. 2171.

5. S. 1039—Senator Packwood

Permanent Extension of Provisions for Qualified Group Legal Services Plans

Present law

Income exclusion

Under present law (Code sec. 120), employer contributions to a qualified group legal services plan and benefits provided under the plan to an employee (or the employee's spouse or dependents) are excluded from the participant's income. This income exclusion for qualified group legal services plans is scheduled to expire on December 31, 1981.

Requirements for qualified plans

A qualified group legal services plan must be a separate written plan of an employer for the exclusive benefit of employees,[1] their spouses, or their dependents.[2] The plan must provide participants with specified benefits consisting of personal (i.e., nonbusiness) legal services by prepaying or providing in advance for all or a part of the participant's legal fees. Plan benefits may consist of legal services provided directly to a participant or cash payments from the plan that are made to or on behalf of the participant to cover the cost of legal services. Direct reimbursement by the employer to the employee is not permitted.

In order to be a qualified plan, a group legal services plan must also meet requirements with respect to nondiscrimination in contributions or benefits and in eligibility for enrollment. The contributions paid by an employer and the benefits provided under a plan may not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. The plan must benefit employees who qualify under a classification which the employer sets up and which the Internal Revenue Service determines does not discriminate in favor of such employees. In determining whether the classification is discriminatory, the employer may exclude from the calculations those employees who are covered by a collective bargaining agreement (as determined by the Secretary of Labor) if there is evidence that group legal services plan benefits were the subject of good faith bargaining between representatives of that group and the employer.

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[1] A sole proprietor or partner is considered to be an employee of the proprietorship or partnership and therefore is eligible for plan benefits.

[2] For this purpose, a dependent is a person who qualifies as such for purposes of the dependency exemption (Code sec. 152).

Contribution limitation

The qualification rules limit amounts that may be contributed under a qualified group legal services plan for employees who own more than five percent of the stock in the employer corporation or more than five percent of the capital or profits interest in an unincorporated trade or business. For any plan year, the aggregate of the contributions for those employees (and their spouses and dependents) must not be more than 25 percent of the total contributions. Constructive ownership rules apply for determining stock ownership or an ownership interest in an unincorporated trade or business.

Restrictions on payments of employer contributions

Amounts contributed by employers under a qualified group legal services plan may be paid only (1) to insurance companies or to organizations or persons that provide personal legal services or indemnification against the cost of personal legal services, in exchange for a prepayment or a payment of a premium; (2) to a tax-exempt organization which forms part of a qualified group legal services plan (Code sec. 501(c)(20)); (3) to a tax-exempt organization which is permitted to receive contributions for a qualified group legal services plan (e.g., a voluntary employees' beneficiary association described in Code sec. 501(c)(9)), provided that the organization then pays or credits the contributions to a tax-exempt organization that forms a part of the qualified group legal services plan; (4) as prepayments to providers of legal services under the plan; or (5) to a combination of the four permissible types of payment arrangements.

Deduction for employer contributions

Employer contributions under a qualified group legal services plan generally are allowed as a trade or business expense deduction to the employer (Code sec. 162).

Tax-exempt status of plan trusts

The income tax exemption for a trust or other organization which forms a part of a qualified group legal services plan (Code sec. 501(c)(20)) is scheduled to expire with the organization's first taxable year ending after December 31, 1981.

Notification

In order to be treated as a qualified group legal services plan, the plan must notify the Internal Revenue Service that it is applying for recognition of its qualified status. If the plan notifies the Service within the time prescribed by Treasury regulations (generally, before the end of the first plan year), the plan will be recognized as a qualified plan from its inception. Otherwise, the plan will be treated as qualified only from the date it actually provides notice.

Issue

The issue is whether the exclusion from an employee's income for employer contributions to and benefits provided under a qualified group legal services plan and the tax exemption of an organization which forms a part of such a plan, now generally scheduled to expire December 31, 1981, should be extended, and if so, whether such provisions should be made permanent.

Explanation of the bill

The bill would make permanent provisions of present law (income exclusion for employees and exempt status for plan trusts) relating to qualified group legal services plans.

Effective date

The provisions of the bill would be effective on enactment.

Revenue effect

It is estimated that the bill would reduce budget receipts by $18 million in fiscal year 1982, $29 million in 1983, $34 million in 1984, $40 million in 1985, and $48 million in 1986.

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