[JOINT COMMITTEE PRINT]

DESCRIPTION OF PROPOSALS

RELATING TO

WITHHOLDING ON INTEREST AND DIVIDENDS

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

ON APRIL 30 AND MAY 1, 1980

PREPARED FOR THE USE OF THE

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INTRODUCTION

This pamphlet provides a description of proposals relating to withholding on interest and dividends, including the Administration's proposal for withholding of tax on interest and dividend payments, background on legislative consideration of withholding on interest and dividends, and related statistical and other information. The Committee on Ways and Means has scheduled hearings on the Administration's proposal for April 30 and May 1, 1980.

The first part of the pamphlet contains a summary. This is followed by a background section in which previous legislative consideration of proposals for withholding on interest and dividends are described. The third part of the pamphlet contains an explanation of present law regarding withholding on wages and salaries and information reporting requirements. Part IV presents a description of the Administration's proposal. In Part V, other current legislative proposals for withholding on interest and dividends are described. Part VI contains revenue estimates of the Administration proposal and estimates of unreported interest and dividend income. Finally, the Appendix presents statistical data relating to interest and dividend income.

I. SUMMARY

Background

For a very limited time in this country's history (1913 to 1916), there was a requirement that tax be withheld on certain interest payments. In the case of dividends, there has never been a withholding system except with respect to payments of certain dividends to foreign persons. A general system for income tax withholding on wages and salaries was first instituted by the enactment of the Current Tax Payment Act of 1943.

Since 1942, the House has on four occasions passed bills providing for withholding either on dividends, interest, or both, and on each occasion the Senate Finance Committee has rejected the proposals.

Present Law

Withholding

Under present law, an employer who pays wages to individual employees must withhold a portion of the wage payments in order to satisfy all, or part of, the employee's Federal income tax. The amount of wages to be withheld from a particular individual generally is determined in accordance with tables prescribed by the Secretary of the Treasury. Individuals whose wages are subject to withholding may be entitled to claim a number of withholding exemptions, generally based upon the number of an individual's allowable income tax exemptions. In addition to these withholding exemptions, individuals who expect to have no tax liability may claim total exemption from withholding.

In addition to withholding on wages and salaries, present law also provides for withholding on certain gambling winnings and, in certain circumstances, on the interest, dividends, and similar types of investment income of foreign investors.

Estimated tax payments

Present law generally requires individuals to make quarterly estimated tax payments if their tax liability is expected to exceed withheld taxes by $100 or more. However, there is no underpayment penalty if estimated tax payments and withheld taxes are at least 80 percent of the tax liability shown on the individual's tax return.

Partial exclusion for interest and dividends

Under present law, the first $100 of dividends received by an individual from domestic corporations is excludable from gross income. For 1981 and 1982, individuals will be able to exclude up to $200 ($400 on a joint return) of dividends and interest received from domestic sources.

Information reporting

In general, amounts which are not subject to withholding under present law are subject to certain information reporting requirements. Generally, persons engaged in a trade or business must file information returns with respect to certain payments (for example, rent, salaries, wages, commissions, fees, other forms of compensation for services, and other fixed or determinable gains, profits, or income) of $600 or more in any taxable year. Information returns also are required with respect to payments of interest and dividends aggregating $10 or more.

Administration Proposal

The Administration has proposed a broad-based program of withholding on dividend and interest payments at a rate of 15 percent. Generally, the proposal would require withholding on payments by commercial and financial institutions, and similar organizations, to individuals, partnerships, and certain trusts.

Payments to corporations (including corporate nominees and corporate trustees), as well as regulated investment companies, collective investment funds managed by banks, money market funds, and the like, would be exempt from withholding. All of these entities, however, would be required to withhold a portion of the payment of dividends or interest to their shareholders or certificate holders. In addition, it is anticipated that an exemption from withholding would be available for individuals who reasonably expect to have no income tax liability.

Other Legislative Proposals

Currently, there are three bills pending which would impose a withholding requirement with respect to payments of dividends and interest. One of these bills (S. 1565) would impose withholding at a rate of 15 percent. The other two (S. 47 and H.R. 1040) would impose withholding at a rate of 10 percent.

II. BACKGROUND

A. Overview

The Tariff Act of 1913 provided for withholding of normal tax with respect to interest, rent, salaries, wages, premiums, annuities, and certain other types of income to the extent that annual payments exceeded $3,000. Dividends were not subject to withholding because they were subject only to a surtax rather than the normal tax. In 1915, the Secretary of the Treasury, in his annual report for the fiscal year, recommended that this withholding system be abolished. The Congress accepted this recommendation and, in the Revenue Act of 1917, a system of information reporting for payments in excess of the personal exemption was substituted for withholding.

Between World War I and World War II, there was no withholding except with respect to payments of certain dividends to foreign persons. In 1941, after tax rates had been increased and tax exemptions had been lowered, the Treasury Department proposed that wages, salaries, interest, and dividends be withheld upon at a rate of 15 percent. In 1942, the House adopted a provision for withholding on wages, dividends, and bond interest. The Senate Finance Committee, however, deleted the provision for withholding on dividends and bond interest and provided instead a provision for withholding of a "victory tax", at a 5 percent rate, on wages and salaries.

The Treasury Department, in 1943, recommended income tax withholding on wages, salaries, and dividends. The Congress, however, in the Current Tax Payment Act of 1943, adopted income tax withholding only for wages and salaries. This Act also established, as a complement to income tax withholding on wages and salaries, the estimated tax system for non-wage earners to put non-wage earners on a generally current tax payment basis.

As part of the Revenue Act of 1950, the House agreed to a provision for income tax withholding on dividends at a rate of 10 percent. However, this provision was deleted from the Act by the Senate Finance Committee. In 1951, the House adopted a provision for withholding on both dividends and interest at a rate of 20 percent. This provision was deleted from the Revenue Act of 1951 by the Senate Finance Committee. An attempt to reinstate the provision on the Senate floor also was defeated.

The Senate Finance Committee again rejected a proposal for withholding on dividends in connection with its consideration of the Rate Extension bill in 1960. A motion to amend that bill on the Senate floor to provide for withholding on both dividends and interest also was defeated.

The most recent legislative approval for extending withholding to dividends and interest occurred in the House-passed version of the

Revenue Act of 1962, which would have imposed withholding on those items at a rate of 20 percent. Again, the Senate Finance Committee deleted the provison and the Committee's decision was sustained on the Senate floor.

The provisions agreed to by the House in the Revenue Act of 1950, the Revenue Act of 1951, and the Revenue Act of 1962 are discussed in more detail below.

B. Revenue Act of 1950

House bill

As part of the Revenue Act of 1950, the House adopted a provision for withholding on dividends, at a rate of 10 percent. The provision was adopted because of the concern of the Ways and Means Committee that a substantial percentage of dividend payments were not being declared as taxable income.[1] While, to some extent, it was felt that this might represent outright evasion, the Committee believed that the major portion of non-reporting of dividends was due to the failure of taxpayers to keep adequate records of the occasional dividend checks they received. (At that time, corporations were required to file information returns only with respect to dividend payments of $100 or more per shareholder during the calendar year.)

Under the proposal, every person making a dividend payment would have been required to withhold 10 percent of the dividend payment. The dividend recipient would have included in taxable income the full amount of the dividend before withholding and would have received a tax credit equal to the amount withheld by the payor. The payor would have been required to report the amount of dividends and withholding to the payee.

Dividends subject to withholding generally would have been distributions to shareholders made out of a corporation's current or accumulated earnings and profits, payments made by a stockbroker as a substitute for a dividend, and patronage dividends. In general, the withholding requirement would not have applied to dividends, which bear a close relationship to interest, paid by financial institutions, dividends paid by mutual insurance companies, corporations owned by governments, or one member of an affiliated group to another.

The legislation contained no provision for individuals to exempt themselves from withholding.

Senate Finance Committee

The Senate Finance Committee deleted the withholding provision from the Revenue Act of 1950 due, in large part, to objections raised at hearings on the measure.[2] The Finance Committee was concerned that implementation of the proposal would involve collection of tax from individuals who had no tax liability because their income was less than their exemptions and deductions, and from organizations which are tax exempt. The Committee also was concerned with the additional expense that withholding would impose upon the payors of dividends. Moreover, the Committee felt that administrative changes with respect to dividend reporting, for example, complete reporting

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[1] H.R. Rep. No. 2319, 81st Cong., 2d Sess. (1950), 1950-2 C.B. 380, at page 406.
[2] S. Rep. No. 2375, 81st Cong., 2d Sess. (1950), 1950-2 C.B. 483, at page 521.

of dividends and a requirement that dividends be itemized on the income tax return of the recipient, would help to correct the problem to which the withholding proposal was directed. The Senate position prevailed in conference.

C. Revenue Act of 1951

House bill

Under the House-passed version of the Revenue Act of 1951, withholding at a rate of 20 percent would have been required with respect to the payment of certain types of dividends, interest, and royalties. Under this provision, there would have been no allowance for personal exemptions. The payor of such items would have been required to remit to the Internal Revenue Service the amounts withheld and to submit a return showing the total amount of dividends, interest, and royalties with respect to which tax was required to be withheld.

The recipient of interest and dividends would have been required to report as income the gross amount received prior to withholding. This would have been accomplished by entering on the tax return (1) the net amount of interest and dividends received after withholding, (2) the amount required to be withheld (which would have been one-quarter of the net amount received), and (3) the sum of the amount actually received and the amount required to be withheld (which would have been the gross amount subject to tax). A credit against tax due then would have been allowed in an amount equal to the amount required to have been withheld. Under this system (unlike the withholding proposed in the Revenue Act of 1950), no withholding receipt would have been furnished to the recipient of dividends or interest. Withholding receipts would have been required, however, in the case of royalties because of the difficulties to the recipient in determining the amounts withheld upon.

In the case of coupon bonds, the owner would, on turning in his interest coupon at a bank, receive 80 percent of the amount of the coupon. The bank also would be paid 80 percent of the face amount by the payor corporation. The remaining 20 percent would be remitted by the payor corporation to the Internal Revenue Service.

Dividends and interest subject to withholding generally would have included payments out of corporate earnings and profits and payments of interest by corporations. Interest subject to withholding generally would not have included payments by thrift institutions, by individuals, or by the United States.

Senate Finance Committee

The Senate Finance Committee rejected the provisions of the House bill dealing with withholding on dividends, interest, and royalties because, while it recognized that there might be substantial underreporting of such income, it did not believe there had been sufficient investigation of the problem to justify withholding.[3] The Committee also believed that the withholding provisions would work a great hardship upon many taxpayers and impose expensive administrative burdens upon withholding agents. The major concern was that withholding would be applied to many taxpayers who had no income

[3] S. Rep. No. 781, 82d Cong., 1st Sess. (1951), 1951–2 C.B. 458, at page 504.

tax liability, and that the hardships resulting from withholding would be most severe for elderly, retired individuals living on a small amount of investment income. In addition, the Committee was concerned that many taxpayers would fail to apply for tax refunds due them and, thus, be deprived permanently of a portion of their income. The Senate position prevailed in conference.

D. Revenue Act of 1962

House bill

In general, under the House-passed version of the Revenue Act of 1962, tax would have been withheld at a 20-percent rate from payments of interest, dividends, and patronage dividends.

The recipient of interest, dividends, or patronage dividends would have been entitled to claim a credit for amounts withheld when filing a final tax return. This withholding system did not require the attachment of any receipt by the recipient of the payment on the return. It also did not require the payor to send any receipt to the recipient. Instead, it was presumed that payors would indicate in some communication to the recipient of the payment that the payment was "net," that is, reduced by one-fifth for amounts withheld.

With respect to interest, the focus of the provision was on payments commonly made to individuals. Interest payments by individuals to creditors, such as commercial banks, were not subjected to withholding nor were interest payments representing ordinary business transactions between banks and business firms.

Dividends, for purposes of withholding, would have been amounts distributed to stockholders out of the current or accumulated earnings and profits of a corporation.

Income recipients who expected no tax liability during a calendar year would have been exempted from withholding, if they filed certificates certifying that they reasonably believed that they would not be liable for payment of any income tax for the year in question. For individuals under age 18, exemption certificates could have been filed whether or not the individuals expected to have any tax liability and, once filed, would not have been required to be filed again; instead, payors would remove their names from their exemption lists at the first of the year in which they became 18.

Exemption certificates generally would have been required to be filed with the dividend or interest payor once a year. However, an exception was provided for corporate and Government bonds because of the difficulty of making exemption certificates work where corporate and Government bonds were transferred from one bondholder to another between interest payment dates. Also, separate exemption certificates would have been required for each transaction in which Government bonds were cashed. In order for an exemption certificate to apply to dividends, stock could not be held in the name of a stockbroker or other nominee. Anyone who willfully filed a false or fraudulent exemption certificate would have been subject to a penalty of not more than $500 and/or one year imprisonment.

The bill would have provided a quarterly refund procedure for certain taxpayers whose income would have been subject to overwithholding. This quarterly refund procedure would not have been available for single taxpayers with gross income of more than $5,000 or married taxpayers with gross income of more than $10,000. In addition, quarterly refunds would not have been available for dependent children.

Senate Finance Committee

The Senate Finance Committee objected that the withholding provisions in the House bill were neither simple nor free of substantial hardship for broad groups of taxpayers. In addition, the Committee was concerned that the provisions would impose a heavy burden on the businesses which would have to perform the withholding and collecting functions for the Government and that there would be numerous tax avoidance possibilities in a system providing exemption certificates.[4]

While deleting the withholding provisions, the Committee agreed, instead, to provide for the reporting of payments of dividends, interest, and patronage dividends exceeding $10 annually per recipient, both to the Government and to the recipient. These reporting requirements were adopted in conference.

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[4] S. Rep. No. 1881, Eighty-seventh Cong., 2d Sess. (1962), 1962–3 C.B. 707, at page 824.

III. PRESENT LAW

A. Income Tax Withholding

In general

Under present law, an employer who pays wages to individual employees (or has employees who report tips) must withhold a portion of the wages paid to satisfy all, or part of, the employee's Federal income tax (Code sec. 3402). The term "wages" is defined generally as all remuneration, unless specifically excluded, for services performed by an employee for an employer, including the cash value of all remuneration paid in any medium other than cash (Code sec. 3401(a)).

The amount of wages to be withheld from a particular individual is determined in accordance with tables prescribed by the Secretary of the Treasury.[1] The withholding rates are graduated and range from 15 percent to 39 percent for single individuals and from 15 percent to 37 percent for married individuals.

Withholding exemptions

Individuals whose wages are subject to withholding may be entitled to a number of exemptions. Each exemption is worth $1,000 and is claimed when filing a Form W-4. Exemptions allowed are (1) one exemption for the taxpayer; (2) one additional exemption for the taxpayer who has attained, or will attain, age 65 during the taxable year; (3) one additional exemption if the taxpayer is blind; (4) one exemption for the taxpayer's spouse (and additional exemptions for age or blindness of the spouse) unless the spouse is claiming the exemptions on a separate return; (5) one additional exemption for each dependent of the taxpayer; and (6) a zero bracket allowance (which is equal to one exemption) unless the taxpayer is married and the spouse receives wages subject to withholding or the taxpayer has withholding exemption certificates in effect with respect to more than one employer. In addition to these withholding exemptions, taxpayers may be entitled to claim additional withholding allowances for excess itemized deductions and tax credits; each such additional allowance exempts $1,000 of annual wages from withholding.

An individual who does not expect that income tax withheld will equal final tax liability may reduce the number of withholding exemptions claimed or the taxpayer may enter into an agreement to increase the amount withheld. Individuals who have had no income tax liability for the preceding year and expect to have no tax liability for the current year may claim total exemption from withholding on wages.

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[1] The current withholding tables are set forth in Circular E (Publication 15) Employer's Tax Guide (Rev. November 1978).

Exemption certificates

In order for an individual to claim exemptions from withholding, the employer must be furnished with a withholding exemption certificate (Form W-4) relating to the number of withholding exemptions claimed. In the case of new employment, this certificate is to be furnished on or before employment begins. If no exemption certificate is furnished, the employee will be considered as claiming no exemptions.

When a change occurs which decreases the number of withholding exemptions which an employee is entitled to claim, the employee must furnish the employer with a new exemption certificate reflecting the correct number of exemptions. Such new certificate must be furnished within ten days after the change occurs. In addition, a new certificate also is required when it no longer is reasonable for an employee, who has claimed a complete exemption from income tax withholding, to anticipate that no income tax liability will be incurred for the current taxable year (Treas. Reg. sec. 31.3402(f)(2)-1(b)).

An employer is required to submit to the Internal Revenue Service a copy of a withholding exemption certificate received from an employee during the reporting period if (1) on the last day of the reporting period, the employee is employed by that employer and claims more than nine withholding exemptions, or (2) the employee claims a complete exemption from withholding (Treas. Reg. sec. 31.3402(f)(2)-1(g), effective for certificates received on or after April 1, 1980). However, this requirement is not applicable if the employer reasonably expects, at the time the certificate is received, that the employee's wages from that employer will not usually exceed $200 per week.

Voluntary withholding

Under present law, annuity or pension payments are subject to withholding to the extent includible in gross income if the payee so requests (Code sec. 3402(o)(1)(B)). Such request must be made in writing to the payor of the annuity or pension.

The amount requested to be withheld from a pension or annuity must be at least $5 per month and must not reduce the net amount of any pension or annuity payment below $10.

Withholding on gambling winnings

In certain circumstances, proceeds from wagers are subject to withholding at a rate of 20 percent (Code sec. 3402(q)). In general, gambling winnings are subject to withholding if the proceeds exceed $1,000 and are at least 300 times as large as the amount wagered. However, special rules apply to winnings from State-conducted lotteries and winnings from sweepstakes, wagering pools, certain parimutuel pools, jai alai, and other lotteries.

The payor of gambling winnings that are subject to withholding is required to file Form W-2G with the Internal Revenue Service Center serving the district in which the principal place of business of the person filing the return is located.

Statements furnished to employees whose wages have been withheld

Every employer who pays wages subject to Federal income tax withholding or Federal Insurance Contributions Act (FICA) withholding must furnish each employee a statement (Form W–2) setting forth: the names of the employer and employee; the amount of wages subject to income tax withholding and the amount withheld; and the amount of FICA wages and FICA tax withheld (Code sec. 6051). In the case of most employees, W–2 Forms for the calendar year must be furnished no later than January 31 of the following year.

Withholding on foreign investors

In general, if nonresident aliens or foreign corporations receive interest, dividends, or other similar types of investment income, a tax at a flat rate of 30 percent is imposed on the gross amount paid (subject to reduction in rate or exemption by U.S. tax treaties) if such income or gain is not effectively connected with the conduct of a trade or business within the United States (Code secs. 871(a) and 881). This tax generally is collected through withholding by the person making the payment of income to the foreign recipient (Code secs. 1441 and 1442). If the interest, dividend, or other similar income is effectively connected with a U.S. trade or business, that income is not subject to the flat 30-percent withholding tax, but instead that income is included in the U.S. income tax return which must be filed for the business and is taxed at the ordinary graduated rates (and is not subject to withholding at source).

There are a number of exemptions from withholding on foreign investors. For example, withholding is not required on payments of interest from deposits with persons carrying on the banking business, and similar institutions (Code secs. 861(a)(1)(A) and 861(c)); on original issue discount on obligations maturing in six months or less (Code secs. 871(a)(1) (A) and (C) and 881(a)(1)); and any interest and dividends paid by a domestic corporation which earns less than 20 percent of its gross income from sources within the United States (Code secs. 861(a)(1)(B) and 861(a)(2)(B)). Moreover, the income of foreign governments from investments in the United States in bonds, stocks, and other securities, or from interest on bank deposits, is exempt from U.S. tax (Code sec. 892).

B. Estimated Tax Payments

Declaration and payment of estimated tax is required of single persons, or married couples with one earner entitled to file a joint return, whose gross income is expected to exceed $20,000 for the taxable year; a married individual entitled to file a joint return, whose gross income is expected to exceed $10,000 for the taxable year, if both spouses receive wages; and a married individual, not entitled to file a joint return, whose gross income is expected to exceed $5,000 (Code sec. 6015). In addition, an individual taxpayer who expects to receive more than $500 from sources other than wages during the year is required to file a declaration of estimated tax. Thus, an individual who expects to receive more than $500 during the taxable year in the form of dividends and/or interest payments generally is required to pay estimated taxes on those amounts. However, no declaration is required if an individual's tax liability for the year, including self employment tax liability, reasonably can be expected to be no more than $100 over the amounts withheld during the year.

For calendar year taxpayers, estimated tax payments are due on April 15, June 15, and September 15 of the current tax year and on January 15 of the following tax year (Code sec. 6153). Fiscal year taxpayers are subject to similar rules as to time of payment. Farmers or fishermen who expect to receive at least two-thirds of their gross income for the calendar year from farming or fishing may elect to wait until January 15 of the following calendar year to file their declaration.

Individuals who fail to pay, in full, an installment of estimated tax on or before the due date may be subject to a penalty which may not be waived for reasonable cause (Code sec. 6654). This penalty, which is applied to the period of underpayment of any installment (currently at a rate of 12 percent), applies to the difference between the payments (including withholding), made on or before the due date of each installment and 80 percent of the total tax shown on the return for the year, divided by the number of installments that should have been made. In addition, present law contains four exceptions to the general underpayment penalty. No penalty is imposed upon a taxpayer if: (1) total tax payments (withholding plus estimated tax payments) exceed the preceding year's tax liability; (2) total tax payments exceed the tax on prior year's income under the current year's tax rates and exemptions; (3) total tax payments exceed 80 percent of the taxes which would be due if the income already received during the current year were placed on an annual basis; or (4) total tax payments exceed 90 percent of the tax which would be due on the income actually received from the beginning of the year to the computation date.

C. Partial Exclusions for Interest and Dividends Received by Individuals

Exclusion for dividends

Under present law, the first $100 of dividends received by an individual from domestic corporations is excludable from gross income (Code sec. 116). In the case of a husband and wife, each spouse is entitled to a separate exclusion of up to $100 for dividends received with respect to stock owned by that spouse. This exclusion does not apply to interest income received by individuals. However, as explained below, this provision of the law has been changed for 1981 and 1982.

Partial exclusion for interest and dividends received by individuals

Effective for 1981 and 1982, individuals will be able to exclude up to $200 ($400 on a joint return) of dividends and interest received from domestic sources.

D. Information Reporting

Information at source

Under present law, persons engaged in a trade or business generally must file information returns with respect to certain payments of $600 or more in any taxable year (Code sec. 6041(a)). Generally, these returns are intended to inform the Internal Revenue Service that specified items have been disbursed by a payor. This information may aid the Service in determining whether the recipient of the item covered by the return has treated it properly for tax purposes. This reporting requirement, subject to various exceptions, applies to payments of rent, salaries, wages, commissions, fees, or other forms of compensation for services, and other fixed or determinable gains, profits, or income, regardless of the medium in which payment is made.

The Internal Revenue Service's information returns program (IRP) matches the information returns filed with respect to payments to some individuals with their income tax returns to detect nonfiling or underreporting of income. Under this program, most information returns filed for individuals on magnetic tape, and some of those filed on paper forms, are included in the IRS document matching program. During 1978, the Service received over 327 million information returns from businesses and organizations required to report wages, interest, dividends, and other payments; more than 264 million of these returns were submitted on magnetic media.[2]

These information returns are required to be filed annually and generally must contain the name, address, and tax identification number of the recipient of the payment (Code secs. 6041(a) and (d)

[2] 1979 Annual Report of the Commissioner of Internal Revenue, page 9.

and 6109(a)). Recipients covered by this reporting requirement must furnish their name and address to the payor (Code sec. 6041(c)). There is no requirement, however, that the payor furnish the recipient with a copy of the return, as is the case for some other returns (see, for example, Code secs. 6042(c) and 6049(c) with respect to information returns of certain dividend payments and interest payments, respectively).

Because these returns must be filed on an annual basis, payors must keep track of the cumulative amount paid to any individual during the year to determine if they have a filing obligation. A $1 penalty is provided for each failure to file an information return (Code sec. 6652(b)). The maximum aggregate penalty per taxpayer for all such failures during any calendar year is $1,000.

Generally, amounts paid to employees, regardless of whether they are subject to withholding, are not reportable on the usual information return (Form 1099). Instead, those amounts are reportable on information returns (Form W-2) which relate to payments to employees.

Returns regarding payments of dividends

Present law imposes information reporting requirements with respect to payments of dividends (Code sec. 6042(a)). In general, every person who makes dividend payments aggregating $10 or more to any other person in a calendar year must file information returns (Form 1099 Div). During a calendar year, any person who receives dividend payments aggregating $10 or more as a nominee and who then pays those dividends over to another person generally must file an information return (Form 1087 Div). In the case of the payment of dividends of less than $10, the requirement of information reporting is discretionary with the Secretary.

These information returns are to be filed with the Service after September 30 for any calendar year, but not before the payor's final dividend payment for the year, and on or before February 28 of the following year (Treas. Regs. sec. 1.6042-2(c)). The returns must set forth the aggregate amount of dividend payments and the name and address of the person to whom paid.

In addition to filing information returns with the Internal Revenue Service, payors of dividends also must furnish statements to recipients of the dividends. These statements must set forth the name and address of the payor of the dividends and the aggregate amount of payments made to the dividend recipient (Code sec. 6042 (c)). Such a statement must be furnished to a dividend recipient no later than January 31 of the year following the dividend payment.

The penalty for failure to file information returns or statements is $10 per return or statement (Code secs. 6652 and 6678). The maximum penalty for aggregate failures in any one calendar year is $25,000.

For purposes of this information reporting requirement, the term "dividend" means any distribution made by a corporation which is a dividend under section 316 of the Code. The term dividend also includes any payment made by a stockbroker to any person as a substitute for a dividend, for example, a payment made on a short sale.

Generally excluded from the dividend reporting requirements are distributions or payments made by foreign corporations, and distributions or payments made to foreign corporations, nonresident aliens, or partnerships not engaged in trade or business in the United States and composed in whole or in part of nonresident aliens. Also excluded from the reporting requirements is the undistributed taxable income of electing small business corporations.

If the payor is unable to determine what portion of a payment represents a dividend or is paid with respect to a dividend, then, for purposes of the information return requirements, the entire amount of the payment is considered to be a dividend or a payment with respect to a dividend.

Returns regarding payments of interest

The information reporting requirements for interest payments are similar to the requirements imposed on dividend payments (Code sec. 6049). In general, every person who makes interest payments of $10 or more to any other person during the calendar year must file information returns (Form 1099 Int). Also, any person who receives interest payments as a nominee and who makes payments aggregating $10 or more to another person during a calendar year must file information returns (Form 1087 Int). In addition, a corporation which issues a bond or other evidence of indebtedness in registered form after May 27, 1969 (unless issued pursuant to a written commitment binding on and after that date), must file an information return if, during the calendar year, an amount of original issue discount aggregating $10 or more is includible in the gross income of any holder (Form 1099 OID). In the case of the payment of interest of less than $10, the information reporting requirement is discretionary with the Secretary. The Secretary also has discretion to require information reporting with respect to corporate interest payments which currently are not covered by the information reporting requirements (Code sec. 6049(a)(3)).

Information returns for the payment of interest must be filed with the Service for the calendar year after September 30, but not before the payor's final payment for the year, and on or before February 28 of the following year. These returns must set forth the aggregate amount of the interest payments and the name and address of the person to whom paid.

Information returns required with respect to original issue discount must be filed with the Service after December 31 for the calendar year and on or before February 28 of the following year. In general, these returns must set forth the aggregate amount includible by each holder of a discount obligation for the period during the calendar year in which the obligation was held; the ratable monthly portion of original issue discount; the issue price of the obligation; and the stated redemption price at maturity.

Payors of interest and persons who are required to file information returns with respect to original issue discount must furnish statements to recipients setting forth the aggregate amount of interest payments or original issue discount. Statements to recipients of interest must be furnished after November 30 of the calendar year and on or before January 31 of the following year. These statements may be furnished at any time after September 30 of the calendar year of payment if furnished with the final interest payment for the calendar year (Treas. Regs. sec. 1.6049–3(c)). Statements for original issue discount must be furnished after December 31 and on or before January 31.

The penalty for failure to file information returns or statements is $10 per return or statement (Code secs. 6652 and 6678). The maximum penalty for aggregate failures in any one calendar year is $25,000.

Included in the term "interest," for purposes of these reporting requirements is: (1) interest on evidences of indebtedness (including bonds, debentures, notes, and certificates) issued by a corporation in registered form, and (to the extent provided in regulations) interest on other evidences of indebtedness issued by a corporation of a type offered by corporations to the public; (2) interest on deposits with persons carrying on the banking business; (3) amounts (whether or not designated as interest) paid by a mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, or similar organization, in respect of deposits, investment certificates, or withdrawable or repurchasable shares; (4) interest on amounts held by an insurance company under an agreement to pay interest thereon; and (5) interest on deposits with stockbrokers and dealers in securities (Code sec. 6049(b)(1)).

Generally excluded from these reporting requirements is interest paid by individuals, for example, interest paid by an individual on home mortgage payments. Also excluded from the term interest are amounts paid on obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of these, or the District of Columbia.

IV. ADMINISTRATION PROPOSAL

A. In General

The Administration proposes a broad-based program of withholding on dividend and interest payments at a 15-percent rate, beginning in January 1981. Generally, the proposal would require withholding on payments by commercial and financial institutions and similar organizations to individuals, partnerships, and certain trusts. Payments to corporations would not be subject to withholding; thus, intercorporate dividends and most commercial or financial transactions would be unaffected. However, further distributions of interest or dividends from a corporate nominee, collective fund manager, brokerage house, or similar organization to an individual would be subject to withholding by the maker of those further payments. An exemption from the withholding requirement would be available to individuals who reasonably expect to have no tax liability with respect to income from any source, as well as non-corporate dealers in securities and tax-exempt organizations.

B. Interest Subject to Withholding

The Administration proposal would require reporting and withholding on all interest payments made with respect to debt obligations of the sort generally offered to the public. The proposal is intended to be as comprehensive as possible in its application to keep the withholding requirement from affecting investment decisions. In particular, withholding would be required on payments for which information reporting to the Internal Revenue Service and the recipient is required under present law. Thus, withholding would be required on payments of (1) interest on bonds, notes, debentures, certificates and other evidence of indebtedness issued by a corporation in registered form, (2) interest on deposits with persons carrying on the banking business, (3) amounts paid by thrift institutions such as savings associations and credit unions in respect of deposits, investment certificates, or withdrawable or repurchaseable shares, (4) interest on amounts held by insurance companies under an agreement to pay interest thereon, and (5) interest on deposits with stockbrokers and securities dealers.

The reporting and withholding requirements would be expanded to encompass payments of taxable interest on all other debt obligations of the sort generally offered to the public. Thus, reporting and withholding would include withholding on obligations of the United States government, unregistered debt instruments issued by corporations, negotiable certificates of deposit, and with respect to the amount of any original issue discount.

Interest payments made to corporate recipients, including regulated investment companies, banks managing collective investment funds, money market funds, and corporate nominees or trustees would be exempt from the withholding requirement. These entities would be required to withhold on the payment of interest to their non-exempt shareholders, certificate holders, or customers.

C. Withholding on Dividends

As is the case with interest withholding, the Administration proposal would build upon the present reporting requirements in requiring withholding on dividend payments. Thus, withholding would be required on any taxable dividend distribution by a corporation [1] to a non-corporate recipient or any payment by a stockbroker to such a recipient as a substitute for a dividend. Dividend payments to corporate recipients including banks, trust companies, brokerage firms, and corporate nominees would not be subject to withholding. These entities would, however, be required to withhold from further payments made to non-exempt individual shareholders or beneficiaries.

D. Time of Withholding

Under the Administration proposal, withholding generally would occur when the interest or dividend would be includible in the gross income of a cash basis taxpayer. In the case of cash payments, withholding generally would occur when the payment is made. In the case of payments included in income by virtue of their constructive receipt (e.g., dividends and interest subject to automatic reinvestment), withholding would occur at the time of constructive receipt. Thus, withholding on short-term discount obligations such as Treasury bills and bankers' acceptances would occur at maturity. Generally, interest on long-term obligations would be subject to withholding as interest payments are made. In the case of Series E and EE United States Savings Bonds, such withholding would occur upon redemption. Withholding with respect to interest in the form of an original issue discount on long-term obligations would be made ratably over the life of the obligation from payments of the stated interest.

Special rules would be provided for payments of interest on accounts with depository institutions. Ordinarily, withholding would occur when an amount is posted to the account, in general not less often than annually; however, an option would be provided for depository institutions to withhold from accounts on an annual basis. The withholding would be accelerated if an account were to be closed and the account could not be reduced below the accrued withholding obligation with respect to the account.

In the case of negotiable obligations sold or transferred between interest payment dates (or any time before maturity in the case of discount obligations), the proposal generally would require that the credit for withheld taxes be assigned to the person who holds the obligation at the time of the withholding.

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[1] For purpose of the present law reporting requirements and thus for this proposal, the term "dividend" is defined in code section 316.

E. Exemptions from Withholding

The Administration proposal would exempt from the withholding requirements payments made to two classes of recipients. First, taxable dividend and interest payments made to corporate recipients would not be subject to tax. These corporate recipients would withhold from any further distributions to non-exempt persons. Thus, for example, dividend payments made to a corporate brokerage firm holding stocks in street name would not be subject to withholding but payment of the dividends to the client or reinvestment on the client's behalf would result in withholding.

Secondly, the proposal would exempt from withholding payments made to certain persons who file exemption certificates with the payor. Persons eligible to file exemption certificates would include (1) organizations exempt from income taxation, (2) noncorporate dealers in securities, (3) individuals who reasonably expect to have no Federal income tax liability on any income, and (4) persons described in regulations issued by the Secretary after consideration of the needs of such persons and the burden that failure to provide for their exemption would impose on payors. Treasury would include under such regulations elderly individuals for whom withholding on interest and dividends would significantly exceed tax liability.

Under the proposal, an exemption certificate filed with the payor would remain in effect until modified by the payee.

The existence of a withholding exemption would not affect the information reporting requirements otherwise imposed on the payor.

V. OTHER LEGISLATIVE PROPOSALS

Currently, there are three bills pending in Congress which would impose withholding on payments of interest and dividends. These bills are S. 47, S. 1565, and H.R. 1040.

A. H.R. 1040 (Mr. Corman)

In general, H.R. 1040 would require every person who makes payments of interest and dividends to deduct and withhold a tax equal to 10 percent of the amounts paid. The withholding agent would be required to file a return and pay over the tax on a quarterly basis no later than the last day of the first month following the close of each quarter of the agent's taxable year.

The bill would authorize the Secretary, through rulings or regulations, to adopt some or all of the provisions of the House-passed version of the Revenue Act of 1962, relating to exemptions and quarterly refunds of withheld taxes. These provisions are discussed above in the background section.

B. S. 47 (Sen. Hatfield)

S. 47 would provide that any person who makes payments of interest or dividends must withhold an amount equal to 10 percent of such payments. The bill would also substantially modify the income tax law and rates. The 10-percent withholding would equal the 10-percent basic income tax imposed under the bill. Furthermore, under the bill, any interest or dividend payment would be treated as if it were a payment of wages by an employer to an employee for a payroll period.

C. S. 1656 (Sen. Bellmon)

In general, S. 1565 would require every person who makes payments of interest or dividends to deduct and withhold a tax equal to 15 percent of the amounts paid. This requirement would apply whether or not the withholding agent is able to determine the person to whom the interest or dividends are payable. In the case of dividends, if the withholding agent could not determine the amount of a distribution which is a dividend, then withholding would be required with respect to the entire amount of the distribution. The withholding agent would be required to file a return and pay over the tax on a quarterly basis no later than the last day of the first month following the close of each quarter of the agent's taxable year.

The bill would provide several exceptions to the general requirement for withholding on interest and dividends. No withholding would be required if there were an exemption certificate in effect which certifies that the taxpayer incurred no income tax liability for the preceding taxable year and has reason to believe that no income tax liability will be incurred for the current taxable year. No withholding would be required if the taxpayer has reason to believe that income tax liability for the current year with respect to interest would not exceed $15. In the case of an individual who is 65 or older, no withholding would be required if the individual has reason to believe that the income tax liability for the current year will not exceed $100. The Secretary could authorize an exemption for any amount of interest paid by the United States (or any wholly owned agency or instrumentality thereof) to the United States (or any wholly owned agency or instrumentality thereof) if the Secretary determines that the imposition of withholding would cause a burden or expense which could be avoided by granting an exemption.

In situations where information returns are required to be filed under present law, with respect to the payment of interest and dividends, the bill would require that such returns indicate the amount of tax withheld on interest and dividend payments, as well as the aggregate amount of the payments.

VI. REVENUE ESTIMATES

Estimates of Unreported Interest and Dividends and of Increased Receipts from Withholding

IRS study on unreported income

In 1979, the Internal Revenue Service published a study of unreported income.[1] The IRS estimated that in 1976 between $7.5 billion and $14.1 billion of interest and dividend income went unreported. On the basis of these estimates, the extrapolation has been made that the midpoint of this range would grow to $17.4 billion in 1981, after taking into consideration the exclusion of $200/$400 for dividends and interest.

Two methods were used to estimate the extent of unreported income for the IRS report. For the high estimate, data from the National Income and Product Accounts (NIPA) was used. Interest and dividend income received by individuals with income below the filing levels and by non-individuals was subtracted from all interest and dividend income reported in NIPA data. The low estimate is the sum of unreported income for tax filers, which was estimated from data of the IRS Taxpayer Compliance and Measurement Program (TCMP),[2] and income estimates for nonfilers from the Exact Match File.[3]

Each method has its advantages and disadvantages. The NIPA method provides a more comprehensive coverage generally, and interest or dividend payments are not likely to be overlooked. Because of its aggregative character, this data can not be used efficiently to determine the interest and dividend income of legitimately nontaxable individuals. The amount of unreporting of income attributed to individuals when using this data is determined as a residual after comparing data on payments and amounts reported on tax returns. The TCMP Exact Match File approach uses actual taxpayer data, and the estimate is the sum of information obtained from each individual. These data, however, are not sufficiently comprehensive, and the totals derived from them would understate the actual payments.

Administration proposal

If 15-percent withholding were imposed beginning January 1, 1981, on the estimated $17.4 billion of unreported dividend and interest income, the increase in calendar year liability would be $2.1 billion in 1981, $2.3 billion in 1982, and $2.6 billion in 1983. Fiscal year re-

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[1] Internal Revenue Service, "Estimates of Income Unreported on Individual Income Tax Returns," Publication 1104 (9–79).

[2] A sample of 50,000 returns selected to represent the tax filing population and subjected to an intensive audit.

[3] The Exact Match File was created in 1973. It combined master file data from the IRS and the Social Security Administration with a survey of 50,000 households to determine the extent of failure to file income tax returns.

ceipts would increase by $1.0 billion in fiscal year 1981, $2.2 billion in fiscal year 1982, and $2.5 billion in fiscal year 1983. This assumes that individuals would continue to underreport as they have in the past, but that they would receive only 85 cents on each dollar of interest and dividend income.

In addition, quarterly withholding on interest and dividends would cause a one-time acceleration of fiscal year receipts to the Treasury, with no change in calendar year liability. Taxpayers who normally pay tax on interest and dividends when they file their returns by April 15th would be withheld up to a year earlier than their customary tax payments, unless they already make quarterly estimated payments or adjust the amount withheld from wage and salary income. This increase in receipts is estimated to be $2.4 billion in fiscal year 1981, and $0.3 billion in each of fiscal years 1982 and 1983.

The total estimated increase in receipts under the Administration proposal is $3.4 billion in fiscal year 1981, $2.5 billion in fiscal year 1982, and $2.8 billion in fiscal year 1983.

APPENDIX: STATISTICAL DATA

A. Present Law Tax on Interest and Dividends

The present law[1] tax on interest and dividends at 1979 income level is estimated to be $25.4 billion on $106.2 billion of income (as shown in table 1[2]). Of the 21.2 million taxable returns, 5.2 million of these returns include a taxpayer age 65 or over (as shown in table 2). Those returns account for 49.1 percent of the interest and dividend income and 43.0 percent of the tax. Interest and dividend income accounts for 43.2 percent of the income reported on returns filed by a taxpayer age 65 or older, as compared to 18.0 percent for all returns.

These estimates do not include 7.1 million nontaxable returns reporting $9.7 billion in interest and dividend income, of which 2.3 million returns include an elderly person and account for $5.5 billion of income.

TABLE 1.—PRESENT LAW TAX ON INTEREST AND DIVIDENDS, AFTER THE $200/$400 EXCLUSION—AT 1979 INCOME LEVEL

[Returns in thousands; dollars in millions]

Expanded income class (thousands)	Taxable returns[1]	Interest and dividend income	Tax on interest and dividend income	Percentage of total tax
Below $5	540	$5, 200	$30	0. 1%
$5–$10	3, 187	11, 508	625	2. 5
$10–$15	3, 520	11, 153	1, 361	5. 4
$15–$20	3, 143	10, 010	1, 528	6. 0
$20–$30	4, 996	17, 232	3, 394	13. 4
$30–$50	3, 954	17, 032	4, 552	17. 9
$50–$100	1, 554	15, 874	5, 911	23. 3
$100–$200	318	8, 083	3, 624	14. 3
$200 and over	88	10, 134	4, 358	17. 2
Total	21, 229	106, 226	25, 383	100. 0

[1] Taxable returns with interest and dividend income.

[1] Including the $200 exclusion for single return and $400 for joint returns scheduled to go into effect in 1981.

[2] Estimates are derived by using average marginal tax rates for taxpayers in each income bracket who have income from dividends and interest.

TABLE 2.—PRESENT LAW TAX ON INTEREST AND DIVIDENDS FOR TAXPAYERS AGE 65 OR OVER, AFTER THE $200/$400 EXCLUSION—AT 1979 INCOME LEVEL

[Returns in thousands; dollars in millions]

Expanded income class (thousands)	Taxable returns [1]	Interest and dividend income	Tax on interest and dividend income	Percentage of total tax
Below $5	91	$2, 290	$4	(2)
$5–$10	1, 447	8, 089	351	3. 2%
$10–$15	1, 371	7, 279	853	7. 8
$15–$20	717	5, 252	738	6. 8
$20–$30	807	8, 161	1, 513	13. 9
$30–$50	449	6, 279	1, 538	14. 1
$50–$100	256	6, 736	2, 351	21. 5
$100–$200	66	3, 474	1, 550	14. 2
$200 and over	26	4, 567	2, 015	18. 5
Total	5, 230	52, 127	10, 912	100. 0

[1] Taxable returns with interest and dividend income.
[2] Less than 0.05%.

B. Withholding on Returns With No Interest and Dividend Liability

Of the 46.6 million returns estimated to report interest and dividends in 1979, 7.1 million were nontaxable, and an additional 18.4 million which were taxable had interest and dividend income less than the $200/$400 exclusion (as shown in table 3). Under the Administration proposal, the 7.1 million nontaxable returns would be eligible to file exemption certificates. The taxpayers who file the 18.4 million returns with no liability on interest and dividends would be eligible to adjust their withholding on wages or their quarterly estimated payments. The Treasury Department estimates that most of them would have sufficient wage, salary or other income with respect to which withholding or quarterly estimated payments may be adjusted in order to compensate for any overwithholding on interest and dividends.

TABLE 3.—RETURNS WITH INTEREST AND DIVIDENDS WHICH HAVE NO INTEREST AND DIVIDEND LIABILITY AT 1979 INCOME LEVEL

[Returns in thousands]

Expanded income class (thousands)	Returns reporting interest and dividends	Nontaxable returns	Returns with less interest and dividends than the $200/$400 exclusion	Elderly returns with no interest and dividend liability
Below $5	6,179	4,889	780	1,230
$5–$10	7,222	1,801	2,377	974
$10–$15	6,802	202	3,086	246
$15–$20	6,607	79	3,389	103
$20–$30	10,776	70	5,711	92
$30–$50	6,720	23	2,743	25
$50–$100	1,888	2	331	6
$100–$200	339		20	
$200 and over	90		2	
Total	46,622	7,067	18,439	2,676

Table 4 shows similar data for returns filed by taxpayers age 65 or over. Of returns filed by these taxpayers, 7.9 million returns are estimated to report interest and dividend income, of which 2.3 million are nontaxable and 392,000 have less than the amount of dividends and interest eligible for the $200/$400 exclusion.

TABLE 4.—RETURNS WITH INTEREST AND DIVIDENDS FILED BY TAXPAYERS AGE 65 OR OVER WHO HAVE NO INTEREST AND DIVIDEND LIABILITY AT 1979 INCOME LEVEL

[Returns in thousands]

Expanded income class (thousands)	Returns reporting interest and dividends	Nontaxable returns	Returns with less interest and dividends than the $200/$400 exclusion
Below $5	1, 322	1, 225	5
$5–$10	2, 409	911	63
$10–$15	1, 617	89	157
$15–$20	820	21	82
$20–$30	899	29	63
$30–$50	474	8	17
$50–$100	262	1	5
$100–$200	66		
$200 and over	26		
Total	7, 895	2, 285	392