[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

ON SEPTEMBER 17, 1979

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

SEPTEMBER 14, 1979

U.S. GOVERNMENT PRINTING OFFICE

50-876 O WASHINGTON : 1979 JCS 37——79

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a hearing on September 17, 1979, by the Subcommittee on Taxation and Debt Management Generally of the Senate Finance Committee.

The pamphlet first briefly summarizes the bills. This is followed by a description of each bill, setting forth present law, the issues involved, an explanation of the provisions, the effective dates, and the estimated revenue effects. Also included is the position of the Treasury Department. The summary and description of the bills are in the numerical order of the bills listed for the hearing.

The bills described in the pamphlet are:

(1) S. 224 (relating to taxation of fringe benefits);

(2) S. 401 (for the relief of the Manhattan Bowery Corporation);

(3) S. 616 (relating to deductions for contributions for the construction or maintenance of fraternal organization buildings);

(4) S. 687 (relating to the tax treatment under the Rhode Island Indian Claims Settlement Act);

(5) S. 736 (relating to the classification of workers as employees or independent contractors);

(6) S. 945 (relating to annuity contracts purchased by the Uniformed Services University of the Health Sciences); and

(7) S. 1514 (relating to tax treatment of interest on certain governmental obligations issued for facilities that convert solid waste into energy).

I. SUMMARY

1. S. 224—Senators Hatch, Stevens, Young, Tower, Domenici, Hayakawa, Helms, Thurmond, Goldwater, Schmitt, and Dole

Taxation of Fringe Benefits

Under present law, gross income generally includes compensation for services paid in a form other than cash. However, under administrative practice, some employee fringe benefits have not been considered to be includible in an employee's gross income.

In 1978, Public Law 95–427 was enacted to prohibit the issuance of any regulation in final form on or after May 1, 1978, and before January 1, 1980, providing for the inclusion of any fringe benefit in gross income under section 61 of the Code.

The bill provides that no fringe benefit regulation shall be issued in proposed or final form after April 30, 1979.

2. S. 401—Senator Moynihan

Termination of Waiver of Exemption from Social Security Taxes Filed by the Manhattan Bowery Corporation

Under present law, services performed for a nonprofit religious, charitable, educational, or other organization exempt from income tax are not covered by social security unless the organization waives its exemption from social security coverage. In general, the bill would terminate retroactively a waiver of exemption from social security coverage filed by the Manhattan Bowery Corporation of New York, New York.

3. S. 616—Senators Dole and Thurmond

Income, Gift, and Estate Tax Deduction for Contributions for the Construction or Maintenance of Buildings Housing Fraternal Organizations

The bill would allow a deduction for Federal income, gift, and estate tax purposes for a contribution or gift to a tax-exempt fraternal organization for the construction or maintenance of a building which is principally used to house the organization.

4. S. 687—Senators Chafee and Pell

Tax Treatment Under Rhode Island Indian Claims Settlement Act

The bill would provide that the lands received by the public corporation established pursuant to the Rhode Island Indian Claims Settlement Act would generally be exempt from Federal, State, or local taxation, except for taxes on income-producing activities and payments for services made in lieu of taxes. The bill would also provide that private owners selling land to be conveyed to the corporation pursuant to the settlement could treat the sales as involuntary conversions, thus allowing deferral of tax on the gain if sale proceeds are reinvested.

5. S. 736—Senator Dole

"Employment Tax Act of 1979"

Under present law, the classification of particular workers as employees or independent contractors for Federal income and employment tax purposes generally is determined under common law rules. Under the common law, if a person engaging the services of another has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is to be accomplished," their relationship is one of employer and employee.

The bill would provide a statutory "safe harbor" test which, if met, would result in an individual being classified as an independent contractor.

6. S. 945—Senators Mathias and Boren

Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences

Present law provides that, if an annuity is purchased for an employee by an exempt organization described in section 501(c)(3) of the Code or by a public school system, the employer's contributions for the annuity contract are excludable, within certain limitations, from the employee's gross income and not subject to tax until the employee receives payments under the annuity contract.

The bill would extend the same rule to qualifying annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences, which was established by the Congress under the Department of Defense to train medical students for the uniformed services.

7. S. 1514—Senators Byrd (Va.) and Warner

Tax Treatment of Interest on Certain Governmental Obligations Issued for Facilities That Convert Solid Waste Into Energy

The bill would permit the issuance of tax-exempt industrial development bonds for facilities which have the function of recovering material from solid waste and any facilities, operated by or on behalf of a government, which have the function of producing gas, heat, or energy, directly or indirectly, from a solid waste disposal process and which are located at the same place as, or adjacent to, a solid waste disposal facility. In addition, the bill would permit the issuance of tax-exempt industrial development bonds for solid waste disposal facilities even though the facility, or any material, gas, heat, or energy that is recovered or results from the disposal process, is to be used by, or for the benefit of, an agency or instrumentality of the United States Government. Further, obligations for such facilities are to qualify for tax-exempt treatment, although the payment of principal or interest on the bonds is to be derived, in whole or in part, from payments made by an agency or instrumentality of the United Sttaes Government.

II. DESCRIPTION OF BILLS

1. S. 224—Senators Hatch, Stevens, Young, Tower, Domenici, Hayakawa, Helms, Thurmond, Goldwater, Schmitt, and Dole

Taxation of Employee Fringe Benefits

Present law

Section 61 of the Internal Revenue Code defines gross income as including "all income from whatever source derived" and specifies that it includes "compensation for services". The regulations (§ 1.61–2 (a) (1)) provide that income includes compensation for services paid for other than in money. Further, the Supreme Court has stated that section 61 "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation whatever the form or mode by which it is effected." [1] In actual practice, however, the "economic benefit" test has not been rigidly followed. Thus, where compensation is paid in some form other than cash, the issue as to taxability has been resolved by statutes, regulations, and administrative rulings which take account of several different factors.

Some fringe benefits, such as the provision of health insurance by an employer for its employees, are expressly excluded from gross income by the Internal Revenue Code; others are excluded by legislation outside the Code; and yet other exclusions are based on judicial authority or on administrative practice. For example, some fringe benefits have been excluded under administrative practice on the basis of a *de minimis* principle, i.e, accounting for the benefit would be unreasonable or administratively impractical. Other items are excluded due to a combination of valuation difficulties and widely held perceptions that the items do not constitute income.

In 1975, the Treasury Department issued a discussion draft of proposed regulations [2] which contained a number of rules for determining whether various fringe benefits constitute taxable compensation. Under the principles contained in the discussion draft, some employee fringe benefits which, as a matter of prior administrative practice, had not been considered to be taxable compensation would have been treated as subject to tax. Other benefits which might be viewed as taxable compensation would not have been taxed under the discussion draft's proposed rules. The discussion draft was withdrawn by the Treasury Department on December 28, 1976.[3] Thus, the question of whether, and what, employee fringe benefits result in taxable income to employees generally continues to depend on the facts and circumstances in each individual case.

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[1] *Commissioner* v. *Smith*, 324 U.S. 177, 181 (1945).
[2] 40 Fed. Reg. 41118 (Sept. 5, 1975).
[3] 41 Fed. Reg. 56334 (Dec. 28, 1976).

In 1978, Public Law 95–427 was enacted to prohibit the Treasury Department from issuing final regulations, under section 61 of the Code, which would govern the income tax treatment of fringe benefits prior to 1980. The Act further provided that no regulations relating to the treatment of fringe benefits under section 61 were to be proposed which would be effective prior to 1980.[1]

Issues

One issue is whether the Treasury Department should be prohibited from issuing final regulations under section 61 of the Code relating to the income tax treatment of fringe benefits. A second issue is whether any prohibition should be for a definite or indefinite period of time. A third issue is whether the prohibition should extend to the issuance of proposed regulations or only to retroactive treatment under regulations proposed during the period of any prohibition but finalized after the expiration of such period.

Explanation of the bill

The bill would prohibit the Treasury Department from issuing final or proposed regulations after April 30, 1979, relating to the income tax treatment of fringe benefits under section 61 of the Code.

Effective date

The bill would be effective upon enactment.

Revenue effect

This bill would continue present administrative practice and thus would have no effect on budget receipts.

Departmental position

The Treasury Department opposes the bill.

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[1] On September 5, 1979, the Senate approved an amendment to the Treasury and Postal Service appropriations bill for fiscal 1980 (H.R. 4393) relating to fringe benefits. The amendment provides that none of the funds appropriated for fiscal year 1980 (through September 30, 1980) are to be used to issue or administer regulations providing for the inclusion of any fringe benefit in gross income by reason of section 61 of the Internal Revenue Code of 1954 unless such fringe benefit was so included as of July 1, 1978. As amended, the bill, H.R. 4393, was passed by the Senate on September 6, 1979.

On September 12, 1979, the House Committee on Ways and Means ordered H.R. 5224 reported. As amended by the committee, this bill would extend the prohibition on the issuance of fringe benefit regulations, under Public Law 95–427, until June 1, 1981.

2. S. 401—Senator Moynihan

Termination of Waiver of Exemption from Social Security Taxes Filed by the Manhattan Bowery Corporation

Present law

Under present law, services performed for a nonprofit religious, charitable, educational, or other organization exempt from income tax under section 501(a) of the Code as an organization described in section 501(c)(3) of the Code are not covered by social security. However, an organization may waive its exemption from employment taxes by filing a waiver certificate (Form SS–15) with the Internal Revenue Service certifying that it desires to have social security coverage extended to the services performed by its employees (Code secs. 3121(b)(8) and 3121(k)(1)).

A waiver of exemption from social security coverage (provided by section 3121(k)(1) of the Code) may be terminated if the organization which has waived its exemption gives two years' advance notice in writing (Code sec. 3121(k)(1)(D)). However, an organization may not terminate its waiver of exemption in this manner unless it has had a waiver in effect for a period of at least 8 years.

Background

The Manhattan Bowery Corporation, a tax-exempt organization, was incorporated under the laws of the State of New York on October 27, 1976. Since its inception, the Corporation has been withholding social security taxes from its employees' wages and has been paying these taxes, along with the employer's share of social security taxes, to the Internal Revenue Service.

In 1974, the Corporation became concerned that it might not have filed a waiver certificate (Form SS–15) waiving its exemption from social security coverage. Accordingly, the Corporation asked the IRS to waive the statutory requirements with respect to the filing of a certificate for waiver of exemption and to credit present and former employees' accounts for all quarters for which social security taxes had been paid. The IRS then informed the Corporation that the Social Security Administration would only adjust or revise earnings records for a limited period of time (i.e., no more than 3 years, 3 months and 15 days preceding the receipt of a notice of error) and that an SS–15 could be filed with an effective date 5 years subsequent to the date of filing The IRS also pointed out that all present and former empoyees of the Corporation would be entitled to make an election as to whether or not they would concur with the filing of an SS–15 (that is, whether or not they wanted social security coverage). These employees who elected not to concur would be entitled to a refund of social security taxes previously withheld, subject to a three-year statute of limitations on the period for which a refund could be granted. Likewise, the Corporation

would be entitled to a refund for the employer's share of social security taxes. Furthermore, those employees who received refunds of social security taxes previously withheld also could elect not to have social security taxes withheld from future wages, thereby foregoing the benefits of social security coverage.

On March 31, 1975, the Corporation filed a Form SS–15 with an effective date of April 1, 1970. Many of the Corporation's current and former employees elected to receive refunds of previously paid social security taxes and some of the Corporation's current employees elected to forego social security coverage for future years.

Between March 31, 1975, when the Form SS–15 was filed, and June 30, 1977, the Corporation did not withhold the employees' portion of social security taxes from those employees who elected not to be covered by social security nor did it contribute the employer's portion of social security taxes with respect to wages paid to those employees.

In March 1977, the Corporation found out that it had, in fact, previously filed a Form SS–15, with an effective date of October 1967. The IRS, therefore, reassessed the social security taxes which had been refunded (except those for the years 1971 and 1972) and demanded repayment of those taxes, along with interest and penalties, as of August 2, 1977. The IRS also assessed the Corporation for social security taxes not collected between April 1, 1975 and June 30, 1977.

The IRS has filed a lien against the Corporation and has informed the Corporation that in the event it is unable to collect the amount of social security taxes due, it may assess a penalty of 100 percent of the uncollected taxes against the officers and directors of the Corporation.

Issue

The issue is whether the Manhattan Bowery Corporation should be allowed to terminate retroactively its waiver of exemption from social security coverage.

Explanation of the bill

Subject to certain conditions, the bill would terminate retroactively the certificate for waiver of exemption from social security coverage filed by the Manhattan Bowery Corporation.

Under the bill, the waiver of exemption of the Manhattan Bowery Corporation would be deemed not to be effective, for purposes of the portion of social security taxes imposed upon an employee (Code sec. 3101), with respect to wages paid by the Corporation to an employee after December 31, 1972, and prior to April 1, 1975, if the Corporation furnishes to the Secretary of the Treasury evidence that it has refunded, prior to February 1, 1977, to such employee (or to his survivors or estate) the full amount of the employee's portion of social security taxes imposed on such wages. In addition, the waiver would be deemed not to be effective, for purposes of the portion of social security taxes imposed upon an employee, with respect to wages paid by the Corporation to an individual as an employee after March 31, 1975, and prior to July 1, 1977, if the Corporation furnishes to the Secretary evidence that such individual was not an employee of the Corporation on June 30, 1978, and that no amount of the employee's portion of social security taxes on such wages were withheld by the Corporation.

Once the provisions of the bill become effective with respect to any wages paid by the Corporation to an employee, none of the taxes imposed upon those wages by section 3101 of the Code (employee's portion of social security taxes) will be payable. In addition, no interest or penalty with respect to the imposition of taxes by sections 3101 or 3111 (employer's portion of social security taxes) of the Code on any wages paid by the Corporation prior to July 1, 1978, will be imposed or collected.

The bill provides that, in the administration of titles II (Federal Old-Age, Survivors, and Disability Insurance Benefits) and XVIII (Health Insurance for the Aged and Disabled) of the Social Security Act, wages to which the bill applies generally will be deemed not to constitute wages for purposes of determining entitlement to, or amount of, any insurance benefit payable on the basis of wages and self-employment income, or entitlement to benefits under title XVIII of the Social Security Act on the basis of wages and self-employment income. This provision, however, will not apply in the case of an individual (or to a person claiming a benefit on the basis of the wages and self-employment income of the individual) who, on or before the date of enactment, (1) dies or attains age 62; (2) is under a disability which began prior to the date of enactment; or (3) enters into an arrangement with the Secretary of the Treasury for paying into the Treasury an amount equal to the employee's portion of social security taxes on the wages, paid to the individual, with respect to which the bill treats the Corporation's waiver of exemption as ineffective. (The Secretary of the Treasury is to prescribe by regulations the manner in which such an arrangement for payment by an individual is to be made, and the Secretary of the Treasury and the Secretary of Health, Education and Welfare are to cooperate in assuring that each individual who is eligible to enter into such an arrangement will be notified and given an adequate opportunity to do so.)

The bill does not relieve the Corporation of any liability for the payment of taxes imposed by section 3111 of the Code with respect to any wages paid by it to any individual for any period.

Effective date

The provisions of the bill relating to wages paid to any employee after December 31, 1972, and prior to April 1, 1975, will not become effective unless, prior to the close of the one-year period beginning on the date of enactment, the Corporation furnishes to the Secretary of the Treasury evidence that it has refunded to such employee the full amount of taxes imposed by section 3101.

The provisions of the bill relating to wages paid to an individual as an employee of the Corporation after March 31, 1975, and prior to July 1, 1977, will not become effective unless, prior to the one-year period beginning on the date of enactment, the Corporation furnishes to the Secretary of the Treasury evidence that such individual was not an employee of the Corporation on June 30, 1978, and that no taxes under section 3101 of the Code were withheld from wages paid to such individual.

Revenue effect

The Service has assessed deficiencies totaling $182,914.96. This bill would reduce the deficiency assessment by $91,457.88, which is the sum of three components. First is the employee share of contributions under section 3101 betwen December 31, 1972 and April 1, 1975. Second, for individuals not employed by the taxpayer on June 30, 1978 the bill waives the employee share of contributions, between March 31, 1975 and July 1, 1977. Lastly, the bill waives interest and penalties with respect to contributions due for these periods for both employee and employer.

Departmental position

The Treasury Department does not oppose the bill but will recommend minor modifications.

3. S. 616—Senators Dole and Thurmond

Income, Gift, and Estate Tax Deduction for Contributions for the Construction or Maintenance of Buildings Housing Fraternal Organizations

Present law

Under present law, a deduction is allowed for Federal income tax purposes (with certain exceptions not relevant here) for contributions to certain specified types of organizations. In the case of contributions to a domestic fraternal society, order, or association, operating under the lodge system, a charitable income tax deduction is allowed only if the contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. In the case of the Federal estate and gift taxes, a transfer or gift to a fraternal society, order, or association operating under the lodge system is deductible only if (1) the transfer or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, (2) the fraternal society, order, or association would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and (3) the fraternal society, order, or association does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

In addition, certain types of organizations are exempt from Federal income tax (other than unrelated business income tax). One of the types of organizations that is exempt from income tax are domestic fraternal societies, orders, or associations, operating under the lodge system if its net earnings are devoted exclusively to religious, charitable, scientific, literary, educational, and *fraternal* purposes and it does not provide for the payment of life, sick, accident, or other benefits (Code sec. 501(c)(10)). Thus, while the net earnings of an exempt fraternal society can be used for religious, charitable, scientific, literary, educational or fraternal purposes, a deduction is not allowable for a contribution to such a society if the contribution may be used for *fraternal* purposes. The Internal Revenue Service has ruled that contributions to an organization or fund for the purpose of acquiring, erecting, or maintaining a building to be used by a fraternal organization in carrying on its activities are not deductible even though some of its activities may be of a charitable nature. Rev. Rul. 56–329, 1956–2 C.B. 125.

Issue

The issue is whether a deduction should be allowed for Federal income, gift, and estate tax purposes for the contribution or gift to a domestic fraternal society, order, or association, operating under the

lodge system, for the construction or maintenance of a building which is principally used to house the organization.

Explanation of the bill

The bill would allow a deduction for Federal income, gift, and estate tax purposes for a contribution or gift to an organization described in section 501(c)(10) for the construction or maintenance of a building the principal purpose of which is to house the organization.

Effective date

The provisions of the bill would be effective for gifts or contributions made after the date of enactment.

Revenue effect

It is estimated that this bill will reduce budget receipts by $5 to $10 million annually.

Departmental position

The Treasury Department opposes the bill.

4. S. 687—Senators Chafee and Pell

Tax Treatment Under Rhode Island Indian Claims Settlement Act

Present law

In 1975, the Narragansett Indian Tribe brought suit against the State of Rhode Island and private landowners based on the Tribe's claims to certain land in Charlestown, Rhode Island. The Tribe argued that these lands had been alienated by it in 1880 in violation of the Trade and Intercourse Act of 1790. The Interior Department has held that the Tribe's claim is "credible." Prior to trial, the parties to the suit entered into a settlement agreement which required both State and Federal legislation for its implementation. Pursuant to the settlement, the Tribe's land claims have been extinguished. A public corporation (which is not a part of the State government) has been created under Rhode Island law with 5 directors to be appointed by the Tribe and 4 by State and local officials (the "Corporation"). The Corporation is to receive 1,060 acres of land now belonging to the State. Also pursuant to the settlement, a fund of $3.5 million has been established in the U.S. Treasury for the purpose of purchasing 900 acres of privately held land in Charlestown at fair market value from its owners. Options have already been secured on 550 acres of this land. The land, when acquired by the Secretary of the Interior with the proceeds of the fund, is to be conveyed to the Corporation.

All land owned by the Corporation is to be held in trust for the benefit of the Tribe. All of the land contributed by the State, and at least 75 percent of the land acquired from private owners, is to be permanently dedicated to conservation purposes. It is anticipated that the Tribe may use the remaining land in other ways which reflect its heritage, or to provide housing for poor or aged members of the Tribe.

The settlement agreement further provided "That the parties to the Lawsuits will support efforts to obtain deferral of both State and Federal income taxes resulting from the conveyance of privately held portions of the Settlement Lands."

The Federal Government's participation in the settlement is under the authority of the Rhode Island Indian Claims Settlement Act, passed in 1978. That law provided for the extinguishment of aboriginal Indian title, creation of the fund for the purchase of the privately held land, and transfer of that land to the corporation to be formed under the settlement agreement. It did not deal with any of the tax consequences of the settlement.[1]

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[1] As introduced, the bill (H.R. 12860, 95th Congress) contained tax provisions identical to the provisions of S. 687. It is understood that these tax provisions were eliminated from H.R. 12860 to expedite passage in the brief time which remained in the 95th Congress after consideration of the legislation in 1978.

While the Federal Government was not directly involved in drafting the settlement agreement itself, the Administration (through the White House, the Office of Management and Budget, and the Interior Department), the staffs of the House Interior and Insular Affairs Committee, the Senate Indian Affairs Committee, and the staffs of the Rhode Island Congressional delegation took part, along with the parties to the settlement agreement, in drafting the 1978 Settlement Act. Thus, these participants supported, with certain exceptions the entire agreement of the parties, including the tax provisions.

It is unclear whether, as the facts and circumstances develop, the Corporation could qualify for general exemption from Federal income tax (Code sec. 501). Also, the Corporation's receipt of land in settlement of the Tribe's damage claim might not be subject to income taxation.

Gain on the sale of property which is involuntarily converted (e.g., sold under threat or imminence of condemnation) may generally be deferred if the taxpayer, for the purpose of replacing the property, purchases property similar or related in service or use to the converted property, if the cost of the replacement property at least equals the amount realized in the conversion. (Code sec. 1033.) Generally, the replacement must occur within 2 years after the first year in which gain is realized. However, in the case of certain real property held for productive use in a trade or business or for investment, up to 3 years for replacement may be permitted.

Issues

The issues presented by the bill are:

(1) the extent to which the settlement land received by the Corporation should be exempt from tax;

(2) whether the private landowners who sell land pursuant to the settlement should be permitted to defer recognition of gain; and

(3) to what extent this bill should serve as precedent for the tax treatment of settlements of other similar suits brought by Indian tribes in other states.

Explanation of the bill

The bill generally would provide that the settlement land and any moneys received by the Corporation from the Treasury fund shall not be subject to any form of Federal, State, or local taxation. Thus, for example, the Corporation would not realize income on receipt of the land and the land would be exempt from local property taxes. (An exemption from local property taxes is also provided in the Rhode Island legislation creating the Corporation.) However, the general exemption rule would not apply to any income-producing activities occurring on the settlement lands, and nothing in the bill would prevent the imposition of payments in lieu of taxes on the Corporation for services provided in connection with the settlement lands. The bill would not affect the question of whether the Corporation generally qualifies for exemption from Federal income taxation.

The bill contains detailed rules as to the circumstances under which amounts received by the Corporation from the Treasury fund would be exempt from tax. However, under the mechanism actually adopted to implement the settlement, the Secretary of the Interior will use the fund to acquire land and will transfer the land to the Corporation, rather than transferring amounts from the fund to the Corporation to enable the Corporation to purchase the land directly. Accordingly, the Committee may wish to delete these provisions since they appear to be unnecessary.

The bill also would provide that, for Federal income tax purposes, any sale or disposition of private settlement lands pursuant to the terms and conditions of the settlement agreement is to be treated as an involuntary conversion. This would permit the sellers to defer gain on the sale to the extent allowed by section 1033.

Effective date

The provisions of the bill would be effective upon enactment.

Revenue effect

It is estimated that this bill would reduce budget receipts by a negligible amount annually for fiscal years 1980 through 1983.

Departmental position

The Treasury Department does not oppose the bill.

5. S. 736—Senator Dole

"Employment Tax Act of 1979"

Present law

a. Determination of status

Under present law, the classification of particular workers as employees or independent contractors for Federal income and employment tax purposes generally is determined under common law rules. Under the common law, if a person engaging the services of another has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is to be accomplished," the relationship of employer and employee is deemed to exist.

In the late 1960's, the Internal Revenue Service increased enforcement of the employment tax laws. As a result, many controversies developed between the IRS and taxpayers concerning the proper classification of workers. These controversies affected a wide variety of workers, including insurance agents, direct sellers, pollsters, oil jobbers, and real estate agents. If the IRS prevailed in reclassifying a worker as an employee, the taxpayer became liable for employment taxes (withholding, social security, and unemployment) with respect to the reclassified workers. In many cases, these reclassifications involved a large number of workers and several tax years.

b. Employer—employee

(*1*) *Social Security* (*FICA*) *taxes.*—For calendar year 1979, employers and employees are required by the Federal Insurance Contributions Act (FICA) to pay social security (FICA) taxes of 6.13 percent each on the first $22,900 of the employee's wages, for a maximum of $1,403.77 each and a total of $2,807.54 per employee.

(*2*) *Federal Unemployment Tax Act* (*FUTA*) *taxes.*—The FUTA tax is levied on covered employers at a current rate of 3.4 percent on wages up to $6,000 per year paid to an employee. Generally, however, a maximum 2.7 percent credit is provided to employers who pay taxes under State unemployment compensation programs. The self-employed are not taxed by, nor included in, the Federal unemployment compensation program.

(*3*) *Income tax withholding.*—In addition to the responsibility for FICA and FUTA taxes, an employer who pays wages to individual employees must withhold for each pay period a portion of the wages to satisfy all, or part, of the employee's Federal income tax.

c. Self-employed individuals

Compensation paid to individuals who are self-employed is not subject to Federal income tax withholding. Rather, self-employed individuals must make quarterly payments of estimated tax directly to

the Treasury. For calendar year 1979, self-employed individuals with net self-employment earnings of $400 or more are required by the Self-Employment Contributions Act (SECA) to pay social security (SECA) tax of 8.10 percent on earnings up to $22,900, for a maximum SECA tax of $1,854.90.

d. Interim rule: Revenue Act of 1978

The Revenue Act of 1978 provided interim relief (until 1980) for certain taxpayers involved in controversies with the IRS concerning the proper classification of workers for employment tax purposes. In general, the Act terminated taxpayers' potential liabilities for Federal income tax withholding, social security and FUTA taxes in cases where taxpayers have a reasonable basis for treating workers other than as employees. In addition, the Act prohibited the issuance of Treasury regulations and Revenue Rulings on common law employment status before 1980.

Issue

The issue is whether statutory standards should be adopted for use in the classification of some workers as independent contractors for employment tax purposes.

Explanation of the bill

The bill would create a statutory test for determining whether an individual would not be classified as an employee. To be an independent contractor under the bill, the following requirements would have to be met:

(1) the individual must control the aggregate number of hours actually worked and substantially all of the scheduling of the hours worked;

(2) the individual must not maintain a principal place of business, or, if he does so, his principal place of business must not be provided by the person for whom such service is performed, or, if it is so provided, the individual must pay such person rent for it. For purposes of this requirement, the individual would be deemed not to have a principal place of business if he does not perform substantially all the service at a single fixed location;

(3) the individual either must have a substantial investment in assets used in connection with the performance of the service, or must risk income fluctuations because his remuneration with respect to such service is directly related to sales or other output rather than to the number of hours actually worked;

(4) the individual must perform service pursuant to a written contract between the individual and the person for whom service is performed which was entered into before performance of the service, which provides that the individual will not be treated as an employee for purposes of employment taxes, and which provides the individual with written notice of his responsibility for payment of self-employment and income taxes; and

(5) the person for whom service is performed must file required information returns.

The bill would permit contracts entered into before January 1, 1981, to satisfy the written contract and notice of tax responsibilities require-

ment if the contract clearly indicates that the individual is not an employee and notice of tax responsibilities is provided to the individual by the payor before January 1, 1981.

The provisions of the bill would not apply to individuals who are designated in Code section 3121(d)(3) as employees (certain agent-drivers, commission-drivers, life insurance salesmen, home workers, and traveling or city salesmen).

Effective date

The provisions of the bill would apply to services performed after December 31, 1979.

Revenue effect

The revenue loss of this bill cannot be estimated because it generally affects individuals whose employment tax status under the present common law rules is the subject of dispute. Therefore, the effect of the bill on FICA, SECA, and FUTA tax liabilities and any effect of the bill's withholding changes on income tax collections are uncertain.

Departmental position

The Treasury Department opposes S. 736, because it would place an increasing number of workers outside of the existing system of withholding and thereby result in significant revenue losses due to the lower social security tax rate imposed upon independent contractors and the high rates of noncompliance in the payment of income and social security taxes that have been proven to exist among workers who are not subject to withholding. These revenue losses would be in addition to a revenue loss of at least $1 billion which the Treasury Department has estimated exists under present law from high noncompliance by independent contractors.

6. S. 945—Senators Mathias and Boren

Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences

Present law

If an annuity is purchased for an employee by an exempt organization described in section 501(c)(3) of the Code or by a public school system, the employer's contributions for the annuity contract are, within certain limitations, excludable from the employee's gross income and not subject to tax until the employee receives payments under the annuity contract (sec. 403(b)). Subject also to limitations generally applicable to tax-qualified retirement plans, the amount excludable in any year cannot exceed 20 percent of the employee's current annual compensation times the number of years of service, less amounts contributed tax-free in prior years.

In P.L. 92–426, Congress authorized establishment (under the Department of Defense) of the Uniformed Services University of the Health Sciences in order to train medical students for the uniformed services. This legislation authorizes hiring civilian faculty and staff members at salary schedules and with retirement benefits similar to those given to the faculty and staff of medical schools in the Washington, D.C. area. On July 15, 1975, the Secretary of Defense approved a tax-deferred annuity program for the faculty, similar to annuities available at certain medical schools in the Washington area and throughout the United States. However, because the University is a Federal instrumentality and is not an exempt organization described in section 501(c)(3), the annuities do not qualify under present law for tax deferral pursuant to section 403(b).

Issue

The issue is whether annuities purchased for the civilian faculty and staff of the Uniformed Services University of the Health Sciences should qualify for income tax deferral in the same manner as annuities purchased for employees of exempt organizations described in section 501(c)(3) or of public school systems.

Explanation of the bill

The bill would treat otherwise qualified annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences in the same manner for income tax purposes (sec. 403(b)) as employee annuities purchased by section 501(c)(3) organizations or by public school systems. Any qualified annuity purchased by the University would be subject to the same limitations as other annuities described in section 403(b).

Effective date

This bill would apply to annuities purchased for service performed after December 31, 1977, in taxable years ending after that date.

Revenue effect

The bill would decrease budget receipts by less than $1 million per year.

Departmental position

The Treasury Department does not oppose the bill.

Prior Congressional action

In the 95th Congress, an identical bill (H.R. 12606) passed the House, but was not acted upon by the Senate Finance Committee or considered by the Senate.

7 S. 1514—Senators Byrd (Va.) and Warner

Tax Treatment of Interest Paid on Certain Government Obligations Issued for Facilities That Convert Solid Waste Into Energy

Present law

Under present law (Code sec. 103), interest on State and local government bonds generally is exempt from Federal income taxation. However, with certain exceptions, interest on industrial development bonds [1] is not exempt from Federal income taxation.

One of the exceptions permits tax-exempt industrial development bonds for solid waste disposal facilities (Code sec. 103(b)(4)(E)). While not defined by the Code, the regulations define solid waste disposal facilities as any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. In addition, the fact that a facility which otherwise qualifies as a solid waste disposal facility operates at a profit will not, of itself, disqualify the facility as an exempt facility. A facility which otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than a solid waste disposal merely because material or heat which has utility or value is recovered or results from the disposal process. Where materials or heat are recovered, the waste disposal function includes the processing of such materials or heat which occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing which converts the materials or heat into other products. For example, solid waste disposal facilities includes the cost of facilities used to burn the solid waste and to convert the resulting heat into steam in a marketable form. However, the cost of transportation pipes or electrical generation equipment [2] used to convert the steam into electricity would not qualify.

In addition, the Internal Revenue Service takes the position that tax-exempt industrial development bonds cannot be used to finance facilities that are used by the United States or its agencies. Tax exemption is denied because the bonds would, in substance, be backed by the Federal Government and, thus, the bonds would be both tax-exempt and Federally insured.

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[1] Under Code section 103(b), a State or local government obligation is an industrial development bond if all or a major portion of the proceeds are to be used directly or indirectly in a trade or business of a person (other than a government unit or a tax-exempt organization) and payment of the principal or interest on the obligation is secured by an interest in, or derived from the payment with respect to, property used in a trade or business.

[2] Under present law, tax-exempt industrial development bonds can be used to finance electrical generation equipment where the facilities are used in the local furnishing of electric energy or gas. (Code sec. 103(b)(4)(E)). Local furnishing of electric energy is defined generally to mean furnishing solely within two contigous counties or a city and a contiguous county.

Issues

The issues are:

(1) Whether tax-exempt industrial development bonds should be used to finance electrical generation equipment (or other energy-producing equipment which functions after the energy or materials derived from solid waste disposal process has been put into its first marketable form) operated by a government which is located on the same site as, or adjacent to, the solid waste disposal facilities where the fuel used to power the electrical generation equipment is solid waste.

(2) Whether tax-exempt industrial development bonds for solid waste disposal facilities should be permitted where the user of the facilities is the United States Government or its agencies.

Explanation of the bill

The bill would make basically two amendments to the provisions of the Code permitting tax-exempt industrial development bonds for solid waste facilities. First, the bill defines the term "solid waste disposal facilities" to include any facility which has the function of recovering material from solid waste and any facility, operated by or on behalf of the governmental unit, which has the function of producing gas, heat, or energy, directly or indirectly, from the solid waste disposal process and which is located at the same place as, or adjacent to, a solid waste disposal facility.

Second, the bill provides that industrial development bonds used to finance solid waste disposal facilities may be tax-exempt where the facility or any materials, gas, heat or energy that is recovered or results from the disposal process is to be used by, or for the benefit of, an agency or instrumentality of the United States Government or where the payment of the principal or interest on the bonds is to be derived, in whole or in part, from payments made by an agency or instrumentality of the United States Government.

Effective date

The provision of the bill would apply to obligations issued after June 30, 1979.

Revenue effect

It is estimated that this bill will reduce budget receipts by $3 million in fiscal year 1980, $14 million in 1981, $39 million in 1982, $81 million in 1983, and $125 million in fiscal year 1984.

Departmental position

The Treasury Department opposes the bill.

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