[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS
(S. 249 and S. 825)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND

DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON APRIL 29, 1983

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on April 29, 1983, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are two bills scheduled for the hearing: S. 249 ("Employee Educational Assistance Extension Act") and S. 825 (exemption from unrelated business income tax for sales of membership lists by certain organizations).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, explanation of provisions, and effective dates.

I. SUMMARY

1. S. 249—Senators Packwood, Bentsen, Symms, Boren, Durenberger, Moynihan, and Pryor, and others

"Employee Educational Assistance Extension Act"

Under present law, an employee's gross income does not include amounts paid or expenses incurred by the employer for educational assistance to the employee pursuant to a program that meets certain requirements (Code sec. 127). This provision is to expire for taxable years beginning after 1983.

The bill would make permanent the exclusion from gross income for amounts paid to, or on behalf of, an employee under a qualified educational assistance program. In addition, the bill would expand the exclusion to cover amounts under a qualified program for educational assistance to the employee's spouse and dependents, and would eliminate the provision under present law that makes the exclusion unavailable if the employee has a choice between educational assistance and taxable benefits. Also, meals, lodging, and transportation expenses incurred under a qualified program would become eligible for the exclusion under the bill. These modifications to the exclusion would be effective for taxable years beginning after 1983.

2. S. 825—Senator Bentsen

Exemption From Unrelated Business Income Tax for Sales of Membership Lists by Certain Organizations

Under present law, certain organizations are generally exempt from Federal income tax because of their religious, charitable, educational, or other nonprofit purposes. However, present law (secs. 511–514) imposes tax on the unrelated business taxable income of tax-exempt organizations, i.e., on gross income derived by the organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business, both subject to certain modifications. An unrelated trade or business is any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

In the case of any tax-exempt organization which is eligible to receive tax-deductible charitable contributions, the bill would exclude from the tax on unrelated business taxable income any income from exchanging, renting, or selling names and addresses of donors to, or members of, such organization. The provisions of the bill would be effective for taxable years ending after the date of enactment.

II. DESCRIPTION OF BILLS

1. S. 249—Senators Packwood, Bentsen, Symms, Boren, Durenberger, Moynihan, and Pryor, and others

"Employee Educational Assistance Extension Act"

Present Law

General rule

Under present law, amounts paid or expenses incurred by an employer for educational assistance provided to an employee are excluded from the employee's gross income if paid or incurred pursuant to a written plan that meets certain requirements and is for the exclusive benefit of the employees (sec. 127). The exclusion applies whether or not the education paid for, or furnished by, the employer is related to the employee's job.

Excludable benefits

Under this provision, an employee can exclude from income educational assistance provided to him or her, but not the value of any assistance provided to the employee's spouse or dependents. Excludable amounts include tuition, fees, and similar expenses, as well as the cost of books, supplies, and equipment paid for, or provided by, the employer. (The exclusion is not available for the cost of tools or supplies provided by the employer if the employee may retain such tools or supplies after completion of the course of instruction.) However, meals, lodging, or transportation may not be excluded under this provision. The exclusion does not apply to educational assistance furnished for courses involving sports, games, or hobbies, unless the education provided involves the business of the employer.

For a program to qualify under this provision, the employee must not be able to choose taxable benefits in lieu of educational assistance benefits. In administering this rule, the business practices of an employer, as well as the written program, are to be taken into account. A qualified educational assistance program need not be funded or approved in advance by the Internal Revenue Service.

The employee may not claim a deduction (e.g., a business expense deduction) or a credit with respect to any amount that is excluded from income under this provision.

Nondiscrimination requirements

For the exclusion to be available, the educational assistance program also must meet certain requirements with respect to nondiscrimination in eligibility.

The program must benefit employees who qualify under a classification set up by the employer and found by the Revenue Service not to be discriminatory in favor of employees who are officers, owners, highly compensated individuals, or their dependents. The program must be available to a broad class of employees, rather than to a particular individual. However, employees may be excluded from a program if they are members of a collective bargaining unit and there is evidence that educational assistance benefits were the subject of good faith bargaining between the unit representatives and the employer or employers offering the program.

A program is not considered discriminatory merely because it is utilized to a greater degree by one class of employees rather than by another class or because successful completion of a course, or attaining a particular course grade, is required for, or considered in, determining reimbursement under the program.

The exclusion does not apply if the share of benefits received by certain employees under the program exceeds a specified level. Specifically, the benefits are not excludable if more than five percent of the benefits are paid to shareholders or owners (or their spouses or dependents, who are employees), each of whom (on any day of the year) owns more than five percent of the stock or of the capital or profits interest in the employer.[1]

Reasonable notification of the availability and terms of the program must be provided to eligible employees.

Treatment of self-employed individuals

An individual who qualifies as an employee within the definition of section 401(c)(1) also is an employee for purposes of these provisions. Thus, in general, the term employee includes self-employed individuals who have earned income for the taxable year, or any prior taxable year, as well as individuals who would have earned income except that their trades or businesses did not have net profits for the taxable year.

An individual who owns the entire interest in an unincorporated trade or business is treated as his or her employer. A partnership is considered the employer of each partner who is also an employee of the partnership.

Payroll tax treatment

Amounts excluded from income as educational assistance are not treated as wages subject to social security (FICA) or unemployment insurance (FUTA) taxes.

Expiration date

This provision is to expire for taxable years beginning after December 31, 1983.

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[1] For determining stock ownership in corporations, this provision uses the attribution rules provided under subsections (d) and (e) of section 1563 (without regard to sec. 1563(e)(3)(C)). Ownership interests in unincorporated trades or businesses are to be determined, under regulations, on the basis of similar principles.

Explanation of the Bill

The bill would make permanent the present-law exclusion from gross income of educational assistance provided to an employee under a qualified program of the employer.

In addition, the bill would make the following four changes in the rules defining a qualified educational assistance program—

(1) The bill would permit an employee's spouse and dependents to receive educational assistance without inclusion of any amount in the employee's income for such benefits;

(2) The provision of present law that prevents an employee from having a choice between excludable educational assistance and taxable benefits would be repealed;

(3) Meals, lodging, and transportation expenses under a qualified program would become eligible for the exclusion; and

(4) The bill would clarify that the provision prohibiting a deduction or credit for amounts excluded from an employee's gross income only applies to a deduction or credit of the employee.

Effective Date

The changes made by the bill are intended to apply to taxable years beginning after December 31, 1983.[2]

[2] The bill as introduced contains a typographical error. The intended effective date is December 31, 1983, rather than 1985.

2. S. 825—Senator Bentsen

Exemption from Unrelated Business Income Tax for Sales of Membership Lists by Certain Organizations

Present Law

General rule

Under present law, certain organizations are generally exempt from Federal income tax because of their religious, charitable, educational, or other nonprofit purposes and functions. However, in light of examples of tax-exempt organizations which had been acquiring and operating, on a tax-free basis, businesses unrelated to their exempt purposes or functions, the Congress enacted the unrelated business income provisions in 1950. These provisions (Code secs. 511–514) impose a tax on the unrelated business income of exempt organizations, primarily in order to remove any unfair advantage which tax-exempt organizations otherwise would have over taxable competitors (S. Rep. No. 2375, 81st Cong., 2d Sess. 28–29 (1950)).

The tax applies to gross income derived by the organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business, both subject to certain modifications. Under one such modification (sec. 512(b)(2)), dividends, interest, annuities, royalties, and, generally, rents from real property are exempted from the tax. (There are special rules with regard to rents from personal property leased with real property.)

Definition of unrelated business

Under present law, an unrelated trade or business is defined as any trade or business of a tax-exempt organization the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

In 1972, the Internal Revenue Service ruled that the regular sale of membership or mailing lists by an exempt educational organization to business firms and universities constitutes an unrelated trade or business (Rev. Rul. 72–431, 1972–2 C.B. 281). The Revenue Service cited Treas. Reg. § 1.513–1(d)(4)(iv) as recognizing that activities carried on by an organization in the performance of exempt functions may generate good will or other intangibles which may be exploited in commercial endeavors. If an organization exploits such an intangible in commercial activities, the regulations provide, the mere fact that the resultant income depends in part upon

an exempt function of the organization does not make it gross income from a related trade or business.

Similarly, the U.S. Court of Claims held in 1981 that income received by an exempt organization from other exempt organizations and commercial businesses for the use of mailing lists constitutes unrelated business taxable income, and does not constitute "royalties" expressly exempted from the tax under section 512(b)(2) (*Disabled American Veterans* v. *U.S.,* 650 F.2d 1128 (1981)). The court found that in renting its donor lists, the DAV operated in a competitive, commercial manner with respect to taxable firms in the direct mail industry; that these rental activities were regularly carried on; and that the rental activities were not substantially related to accomplishment of exempt purposes (apart from the organization's need for or use of funds derived from renting the mailing lists).

Explanation of the Bill

In the case of any organization exempt from tax under section 501 which is eligible to receive tax-deductible charitable contributions under section 170,[1] the bill would exclude from the term unrelated trade or business any trade or business of such organization that consists of exchanging, renting, or selling names and addresses of donors to, or members of, such organization.

Effective Date

The provisions of the bill would be effective for taxable years ending after the date of enactment.

[1] Specifically, Code sec. 170(c) defines charitable contributions as including contributions or gifts to or for the use of: (1) certain religious, charitable, or educational organizations in the United States; (2) certain organizations of war veterans and their auxiliary units; (3) certain fraternal organizations, if the gift is used exclusively for religious, charitable, or educational purposes; (3) certain nonprofit cemetery companies; and (4) the United States or any of its political subdivisions.

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