[COMMITTEE PRINT]

DESCRIPTION OF H.R. 318, H.R. 1680, AND H.R. 4090, BILLS LISTED FOR A HEARING BY THE COMMITTEE ON WAYS AND MEANS ON MARCH 21, 1977

PREPARED FOR THE USE OF THE

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BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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I. INTRODUCTION

The bills described in this pamphlet are those on which the Committee on Ways and Means has announced a one-day public hearing for Monday, March 21, 1977.

In connection with this hearing, the staff of the Joint Committee has prepared a description of the bills, similar to the descriptions the staff was directed to prepare in connection with the hearings on miscellaneous bills in the last Congress.[1]

The pamphlet first briefly summarizes the bills in consecutive bill number order. This is followed by a more detailed description of each bill indicating in each case the present law treatment, the issue involved, an explanation of what the bill would do, any prior Congressional consideration of the bill, the effective date of the provision, the revenue effect of the provision, and the position of the Treasury Department with respect to the bill.

[1] The description which the staff was directed to prepare in the last Congress were to indicate whether any of the bills were retroactive and to name any particular taxpayer to which a bill might be directed if the staff had such information. The bills included in this hearings, however, deal with general provisions included in the Tax Reform Act of 1976.

II. SUMMARY

1. H.R. 318—Mr. Robert W. Daniel, Jr.

Sick Pay

The bill would delay for one year, to taxable years beginning after December 31, 1976, the changes made by the Tax Reform Act of 1976 with regard to the exclusion of sick pay from income. The major changes made by the 1976 Act in this provision include the following: the exclusion is available only if the taxpayer is permanently and totally disabled; the exclusion is phased out for adjusted gross incomes of more than $15,000; and, under certain circumstances if a taxpayer wishes to recover tax-free the amount of any contributions he or she made to an annuity program, the taxpayer must make an irrevocable election not to use the sick pay exclusion for that year and any subsequent year.

2. H.R. 1680—Ms. Keys

Relief from Interest and Penalties Attributable to Application to 1976 of Provisions of the Tax Reform Act of 1976

A number of provisions of the Tax Reform Act of 1976 apply to calendar year 1976. The bill would bar the imposition of additions to tax on account of underpayment of estimated tax to the extent that these underpayments are attributable to changes made by the 1976 Act. The bill would also relieve employers of liability for failure to withhold income tax, during 1976, on sick pay and other types of remuneration made taxable by the 1976 Act. In addition, the bill would provide relief from the requirement of paying interest on underpayments attributable to changes made by the 1976 Act, in the case of taxpayers with short taxable years or with fiscal years ending before December 31, 1976.

3. H.R. 4090—Mr. Waggonner

Withholding on Certain Gambling Winnings

The bill would reduce the withholding requirements enacted in the Tax Reform Act of 1976 so as to impose the 20-percent withholding tax on one-half of the proceeds of $1,000 or more from any single wager placed in a wagering pool with respect to horse races, dog races, or jai alai; there would be no withholding unless the amount of such proceeds is at least 300 times as large as the wager. In addition, the bill would eliminate the reporting requirement for gambling winnings to which withholding applies and for all winnings from parimutuel activity with respect to horse races, dog races, or jai alai.

III. DESCRIPTION OF BILLS

1. H.R. 318—Mr. Robert W. Daniel, Jr.

Sick Pay

Pre-1976 law

Under the law before the Tax Reform Act of 1976, gross income did not include amounts received under a wage continuation plan ("sick pay") when an employee was "absent from work" on account of personal injuries or sickness (sec. 105(d)).

The proportion of salary covered by the wage continuation payments and any hospitalization of the taxpayer determined whether or not there was a waiting period before the exclusion applied. If the sick pay was more than 75 percent of the regular weekly pay rate, the waiting period before the exclusion became available was 30 days whether or not the taxpayer was hospitalized during the period. If the rate of sick pay was 75 percent or less of the regular weekly pay rate and the taxpayer was not hospitalized during the period, the waiting period was 7 days. If the sick pay was 75 percent or less of the regular weekly pay rate and the taxpayer was hospitalized for at least 1 day during the period, there was no waiting period and the sick pay exclusion applied immediately. In no case could the amount of "sick pay" exclusion exceed $75 a week for the first 30 days and $100 a week after the first 30 days.

During the period that a retired employee was entitled to the sick pay exclusion, he or she could not recover any of his contributions toward any annuity under section 72.[1]

Present law—Tax Reform Act of 1976

The sick pay provision was revised because the Congress believed that the prior law was too complex, had a regressive effect, and should provide a more equitable share of benefits to low- and middle-income taxpayers.

The Act repealed the prior sick pay exclusion and continued the maximum exclusion of $100 a week ($5,200 a year) only for taxpayers under age 65 who have retired on disability and are permanently and totally disabled. For this purpose, "permanently and totally disabled" means unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. A taxpayer is considered to be "retired" even if not formally placed on retirement if he or she receives some other form of income in lieu of wages, such as accumulated leave, provided he or she is not expected to return to work.

The maximum amount excludable is reduced on a dollar-for-dollar

[1] Treas. Reg. § 1.72–15 (b) and (c) (2) and 1.72–4(b) (2) (iv).

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basis by the amount of the taxpayer's adjusted gross income (including disability income) in excess of $15,000. Thus, a taxpayer who receives $5,200 in disability income and $15,000 (or more) in other income, which together equal $20,200 (or more), is not entitled to any exclusion of his or her disability payments.

In order to claim this exclusion, a taxpayer who is married at the close of a taxable year must file a joint return with his or her spouse, unless they have lived apart at all times during that year. Each qualifying spouse is entitled to a separate, maximum $5,200 exclusion, but the phaseout for adjusted gross income in excess of $15,000 applies on a per-return basis.

The Act also provided several transitional rules. One of the transitional rules allows taxpayers who retired on disability before January 1, 1976, and who were entitled to a sick pay exclusion on December 31, 1975, also to benefit from the section 72 annuity exclusion before age 65, if they make an irrevocable election not to claim the disability exclusion.

The Act also provided that, upon reaching age 65, the taxpayer can begin to recover his or her investment in an annuity contract (if any) under section 72. A special rule enables certain permanently and totally disabled taxpayers who determine that they will not be able to claim any (or little) sick pay exclusion to benefit from the section 72 exclusion before age 65. Under this rule, the taxpayer may make an irrevocable election not to seek the benefits of the disability income exclusion for that year or subsequent years.

The Act, which was signed into law on October 4, 1976, applied the sick pay revisions to taxable years beginning after December 31, 1975.

Issue

The question is whether the 1976 Tax Reform Act changes in the sick pay rules should be applied to 1976 (as provided in the 1976 Act) or whether these changes should first go into effect in 1977. If the one-year postponement is adopted, a further question arises as to whether taxpayers who make "irrevocable" elections on their 1976 returns never to claim the sick pay exclusion should be bound by their elections.

Explanation of bill

H.R. 318 would change the effective date of the sick pay revisions from taxable years beginning after December 31, 1975, to taxable years beginning after December 31, 1976. This would relieve taxpayers of Federal income tax on sick pay for taxable years beginning before 1977.

The Internal Revenue Service believes that the only feasible method of administering a change in the effective date would be to have taxpayers file amended returns for 1976 and claim a refund. The Service has already printed and distributed the Federal income tax forms and instructions for 1976. Both the forms and instructions are based on the law as amended by the Tax Reform Act of 1976. Many taxpayers have already filed their 1976 returns and paid their income tax. The Service anticipates that the enactment of H.R. 318 would increase the number of individual amended returns for 1976 by about 1 million more than the approximately 900,000 amended returns filed in a normal year. The Service estimates that processing the extra amended returns will cost $6 million.

The following House bills in the 95th Congress are identical to H.R. 318: H.R. 1471, H.R. 1646, H.R. 1828, H.R. 1972, H.R. 2036, H.R. 2585, and H.R. 2786.

Effective date

The bill would take effect as of October 4, 1976 (the date of enactment of the Tax Reform Act of 1976).

Revenue effect

The one-year postponement of the sick pay revisions would decrease revenues by $327 million in fiscal year 1977.

Other Congressional consideration

On March 16, 1977, the Senate Finance Committee tentatively agreed to amend H.R. 3477 (the Tax Reduction and Simplification Act of 1977) by adding a provision to delay for one year (to taxable years beginning after December 31, 1976) the effective date of the sick pay exclusion changes made by the Tax Reform Act of 1976.

Departmental position

The Treasury Department does not support the bill. The Department notes that delaying the effective date of the sick pay provision would create substantial taxpayer confusion and would cause the Internal Revenue Service serious administrative difficulties.

2. H.R. 1680—Ms. Keys

Relief From Interest, Additions to Tax, and Penalties Attributable to Application to 1976 of Provisions of the Tax Reform Act of 1976

Present law

Under existing law, where the withholding of income taxes from wages does not fully take account of an individual's total income tax liability, the individual, in general, is required to file estimated tax returns and make estimated tax payments. Also, corporations are normally required to make quarterly estimated tax payments. An underpayment of an estimated tax installment will, unless certain exceptions are applicable, result in the imposition of an addition to tax which is computed at a rate of 7 percent per annum on the amount of underpayment for the period of underpayment (secs. 6654 and 6655).

The Code requires the payment of interest at a rate of 7 percent per annum on the amount of an underpayment of tax liability from the last date for paying tax on any amount which should be shown on a return, without regard to any extension of time for payment (sec. 6601).

The Code also requires employers to deduct and withhold income tax from employees' wages (sec. 3402(a)) and imposes an addition to tax of 5 percent on the amount of the underpayment in the case of a late deposit of withheld taxes (sec. 6656(a)), as well as a 100-percent penalty for willful failure to collect, account for, and pay over the taxes required to be withheld (sec. 6672).

Tax Reform Act of 1976

The Tax Reform Act of 1976, enacted on October 4, 1976, made several changes which increase tax liabilities from the beginning of 1976. (See, for example, the discussion of the sick pay provisions under H.R. 318, above.)

In prior legislation (such as the Tax Reform Act of 1969) which passed the Congress late in the year but which imposed tax increases from the beginning of the year, the Congress, as a matter of equity and custom, has relieved taxpayers of any liability for additions to tax, interest, and penalties with respect to increases in estimated tax resulting from tax liability increases arising for that year under the legislation. Relying on Congressional assurances that the failure to provide such relief in the 1976 Act was an oversight which would be remedied, the Commissioner of Internal Revenue announced that the Service would defer assessing any additions to tax, interest, or penalties with respect to increased estimated tax liabilities for 1976 taxable years caused by the Tax Reform Act of 1976, in anticipation of legislative action.

However, in the absence of specific legislative relief, the Service will eventually have to enforce the law and assess the additions to tax, interest, and penalties, because of underpayments of tax or failures to withhold and deposit income tax which are attributable to the tax-increasing provisions of the 1976 Act, such as the sick pay revision. Moreover, in cases where the Service may have assessed an addition to tax because of underpayment of estimated tax—the taxpayer, for example, may have indicated the addition to tax on an already-filed return—there is no authority to abate the assessment in the absence of further statutory change.

Issue

The questions are (1) whether taxpayers should be liable for interest or additions to tax for 1976 (until April 15, 1977, for individuals and until March 15, 1977, for corporations) on account of underpayments attributable to changes made by the Tax Reform Act of 1976 and (2) whether employers or others required to withhold income tax during 1977 should be liable for failure to withhold to the extent that the duty to withhold was created or increased by the 1976 Act.

Explanation of bill

The bill is designed to relieve taxpayers from additions to tax, interest, and penalties (but not liability for tax) attributable to changes in the tax law which were made applicable to 1976 by the Tax Reform Act of 1976.

Thus, the bill would allow individual taxpayers until April 15, 1977, and corporations until March 15, 1977, the final filing dates for calendar year returns, to pay their full 1976 income tax liabilities without incurring any additions to tax on account of the underpayment of estimated tax, to the extent that the underpayments are attributable to changes in the law made by the Tax Reform Act of 1976.

The bill also would relieve employers of any liability for failure to withhold income tax, during 1976, on sick pay and other types of remuneration which were made taxable by the 1976 Act.

In addition, the bill would provide relief for taxpayers with short taxable years or with fiscal years ending before December 31, 1976. No interest would be due in such cases on underpayments attributable to changes made by the 1976 Act through April 15, 1977, for individual taxpayers, and through March 15, 1977, for corporations.

Provisions similar to the provisions in this bill were included in the Tax Reform Act of 1969 (sec. 946 of the 1969 Act) and the Revenue Act of 1971 (sec. 207 of the 1971 Act).[1]

[1] Since neither of these Acts eliminated exclusions of income in circumstances where the elimination of such exclusions had the effect of requiring wage withholding on such previously excludable items, neither Act contained a provision similar to the provision of this bill which would relieve employers of the duty to withhold on such items.

By contrast, the 1976 Act had the effect of requiring withholding for 1976 on certain items which, but for the enactment of the 1976 Act, would have been excludable from income as sick pay (sec. 105(d) of the Code) or as earned income from foreign sources (sec. 911 of the Code).

H.R. 2087, and H.R. 2827 are identical to H.R. 1680.

Effective date

The bill would take effect on the date of enactment.

Other Congressional consideration

On March 16, 1977, the Senate Finance Committee tentatively agreed to amend H.R. 3477 (the Tax Reduction and Simplification Act of 1977) to include a provision essentially similar to H.R. 1680.

Departmental position

The Treasury Department supports the bill. The Committee should recognize, however, that the Service will not be able to identify those returns where the underpayment is attributable to the retroactive provisions but will have to depend upon the taxpayer to notify the Service that the penalty should not have been asserted.

3. H.R. 4090—Mr. Waggonner

Withholding on Certain Gambling Winnings

Pre-1976 law

Under prior law, withholding on racetrack winnings was not required, although payouts to winners of daily doubles, exactas, and similar wagering pools were reportable on Form 1099 information returns if the payout was $600 or more and was based on odds of 300 to one or higher.

Present law—Tax Reform Act of 1976

Although most wagering transactions may have no ultimate income tax significance, since the majority of bettors do not have net wagering gains at the end of the year, special types of wagers involving high odds may result in unique and occasional windfalls that generally produce significant tax liability. Even with the information reporting requirements, many taxpayers may not report these winnings on their tax returns.

To deal with the underreporting of gambling winnings, the Tax Reform Act of 1976 supplemented the information reporting requirement with a provision for withholding 20 percent of net winnings of more than $1,000 from sweepstakes, wagering pools, and lotteries (other than State-conducted lotteries).

Explanation of bill

H.R. 4090 would revise the withholding requirement to impose the 20-percent withholding tax on one-half of the proceeds of $1,000 or more from any single wager placed in a wagering pool with respect to horse races, dog races, or jai alai, but only if the amount of such proceeds is at least 300 times as large as the wager. In addition, the bill would eliminate the Form 1099 reporting requirement for gambling winnings to which withholding applies and for all winnings from parimutuel activity with respect to horse races, dog races, or jai alai.

Effective date

The withholding provision of the Tax Reform Act of 1976 became effective on January 4, 1977. However, on December 21, 1976, in response to a letter from Chairmen Ullman and Long, the Commissioner of Internal Revenue announced he would postpone enforcement of the provision to provide Congress time to consider legislative change. This administrative postponement currently extends through April 30, 1977. H.R. 4090 contains no effective date provision.

Revenue effect

It is estimated that the bill would reduce budget receipts by $20 million in each of the fiscal years 1977 and 1978.

Prior Congressional consideration

On the last day of the 94th Congress, the Senate passed H.R. 10902, with an amendment to modify the withholding requirement (in the case of horse races, dog races, and jai alai) to apply to winnings of $600 or more based on odds of 200 to 1 or higher. This amendment, in lowering the dollar threshold for withholding but introducing an odds requirement, was intended to be a revenue-neutral method of solving the horse racing industry's objection to the flat $1,000 threshold. H.R. 10902 also would have excluded from the information return requirements any payments that are subject to the withholding requirements. There was insufficient time for the consideration of H.R. 10902, as so amended, in the House of Representatives before adjournment *sine die*, and so that bill died at the end of the 94th Congress.

Departmental position

The Treasury Department is opposed to the bill unless the bill is modified. The Treasury Department would support a modification of this withholding provision which provides for withholding on winnings of $600 or more where the odds were 200 to 1 or greater. Such a modification would result in no revenue loss over present law.

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