

## EXCLUSION FROM GROSS INCOME OF CERTAIN AMOUNTS DISTRIBUTED BY UNITED STATES TO NONRESIDENT ALIEN INDIVIDUALS

JANUARY 19, 1960.—Ordered to be printed

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

### REPORT

[To accompany H.R. 135]

The Committee on Finance, to whom was referred the bill (H.R. 135) to provide an income credit in the case of civil service annuities received by nonresident alien individuals not engaged in trade or business within the United States, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended to pass.

The amendment is as follows:

On page 3, line 4, strike out "1958" and insert "1959".

#### I. SUMMARY OF THE BILL

H.R. 135 excludes from U.S. tax for nonresident alien individuals the portion of amounts paid to them by the United States as civil service annuities and other retirement benefits for services performed abroad as employees of the United States. The exclusion under the bill as amended by your committee applies for taxable years beginning after December 31, 1959. The Treasury Department favors the enactment of the bill as amended, and its statement, together with another favorable statement from the Civil Service Commission, are attached as appendixes to this report.

#### II. GENERAL STATEMENT

Under present law civil service annuities and certain other retirement benefits provided by the United States are treated as distributed under "qualified" pension plans, and when distributions are made to the annuitant he is not taxed on the portion of the payment representing his own contributions to the pension. In addition, he is

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not taxed on contributions by the employer if these amounts would not be taxable to him had the employer made the payments directly to him.

A nonresident alien working for an American embassy or other Government agency abroad presently is not subject to U.S. tax on the salary paid him by the United States since this is income from sources without the United States. In the case of a U.S. civil service retirement pension, the amounts set aside by the Government for the future retirement of a nonresident alien working abroad also are free of tax since if these amounts were paid to him directly they would not be subject to tax. However, to the extent the annuity represents earnings on the amount set aside by the Government, a tax is due on the payments because this is considered as investment income from sources within the United States. On this portion of the annuity payments a 30-percent withholding tax generally is applicable.

The Department of State has indicated that nonresident alien employees consider their pensions to be deferred compensation, and since their earned income is tax free, they expect their pensions also to be tax free. Your committee has also been informed that the imposition of this tax upon the retirement benefits of nonresident aliens has caused severe hardships and has engendered resentment against the United States because of its failure to comply with what is assumed to be its contractual obligation to pay retired alien employees a pension consisting of a specified sum of money.

It has been further pointed out to your committee that the nonresident aliens affected by this tax on their annuities are all former employees, or their dependents, of the United States who, in most cases, have given a lifetime of valuable service to the U.S. Government and who have planned their retirement upon the basis of tax-free pensions. This tax treatment has been objected to by many foreign governments; and some, especially the Government of the Republic of the Philippines, have repeatedly protested the imposition of this tax.

In view of these considerations this bill adds a paragraph (4) to the provision dealing with the taxability of beneficiaries of employees' trusts (sec. 402(a)). This paragraph provides that amounts paid to a nonresident alien individual by the United States in respect of services performed by an employee of the United States are not to be taxable to him to the extent they are attributable to basic U.S. salary derived from sources without the United States. This will mean that for the typical nonresident alien who has worked for the United States only abroad, no U.S. tax will be payable with respect to his pension.

This provision as amended by your committee is effective for taxable years beginning on or after January 1, 1960.

This bill is expected to have only a negligible effect on revenues.

### III. TECHNICAL EXPLANATION OF THE BILL, AS REPORTED

This bill, as reported, amends section 402(a) of the Internal Revenue Code of 1954 (relating to taxability of beneficiary of exempt employees' trust) to provide an additional exclusion for certain nonresident alien individuals with respect to retirement benefits received from the United States.

Section 402(a) contains the provisions relating to the taxation of distributions from an employees' trust described in section 401(a)

and exempt under section 501(a). Section 402(a)(1) provides, in general, that, except in the case of certain lump-sum distributions, distributions from such an employees' trust are taxable under section 72 (relating to annuities). Section 402(a)(2) provides capital-gain tax treatment in the case of certain lump-sum distributions from such an employees' trust. Under both section 72 and section 402(a)(2), the recipient of the distribution is permitted to recover tax free that portion of the distribution which represents the employee's contributions to the trust. In determining the employee's contributions to the trust, there are included any amounts contributed by the employer in any case when such amounts would not have been includible in the gross income of the employee if they had been paid directly to him rather than to the trust. On the other hand, some portion of the total distributions received from the trust is generally includible in gross income. For example, if the employee was a nonresident alien during the whole of his employment with the United States and all his services were performed outside the United States, there is generally includible in gross income an amount representing the interest increment on the employee and employer contributions.

The first section of the bill amends section 402(a) by adding a new paragraph (4) which provides an additional exclusion from gross income in the case of retirement benefits paid by the United States from an exempt trust if such benefits are paid to a nonresident alien individual. Under the new paragraph (4), the amount of the benefit which is includible in gross income by the nonresident alien individual shall not exceed an amount which bears the same ratio to the amount includible in gross income under the present provisions of law (secs. 72 and 402(a)(2)) as (1) the aggregate basic salary paid by the United States for the services in respect of which the benefit is paid, reduced by the amount of such basic salary which was not includible in gross income by reason of being from sources without the United States, bears to (2) the aggregate basic salary paid by the United States for such services. In determining the amount includible in gross income under the new paragraph (4), it is necessary to first compute the amount includible under section 72 or section 402(a)(2) (whichever is applicable) and then apply to that amount the ratio provided in the new paragraph (4). Under the rules of the new paragraph (4) therefore, no part of the amount otherwise includible in gross income by the nonresident alien individual under section 72 or section 402(a)(2) will be includible if all of the services with respect to which the retirement benefit is paid by the United States were performed outside the United States by a nonresident alien employee, since the numerator of the ratio in paragraph (4) would be zero. On the other hand, if part of such services were performed in the United States or were performed while the employee was a citizen of the United States, then the numerator of the ratio is not zero and a portion of the benefit may be includible in gross income. The provisions of paragraph (4) would have no effect on retirement benefits received from the United States by a nonresident alien individual as the beneficiary of an employee of the United States who was a U.S. citizen for the entire period of his employment with the United States, or who performed all of such employment in the United States, since the numerator and denominator of the ratio in paragraph (4) would be the same.

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In the case of retirement benefits paid under the Civil Service Retirement Act (5 U.S.C. 2251), the term "basic salary" is defined by the new paragraph (4) to have the meaning provided in section 1(d) of such act. In the case of distributions under other U.S. retirement plans, the term "basic salary" has a similar meaning.

The first section of the bill also amends section 402(a)(1) to provide a reference to the new paragraph (4). Section 2 of the bill amends section 871(d) (relating to tax on nonresident alien individuals) to insert a cross-reference to the special tax treatment provided in the new section 402(a)(4).

Section 3 of the bill, as amended by your committee, provides that the amendments made by the bill shall apply only with respect to taxable years beginning after December 31, 1959.

#### IV. APPENDIXES—STATEMENTS OF TREASURY AND CIVIL SERVICE COMMISSION

OFFICE OF THE SECRETARY OF THE TREASURY,  
*Washington, December 21, 1959.*

HON. HARRY F. BYRD,  
*Chairman, Committee on Finance,*  
*U.S. Senate, Washington, D.C.*

MY DEAR MR. CHAIRMAN: This is in response to your request for the views of this Department on H.R. 135, a bill to amend the Internal Revenue Code of 1954 to exclude from gross income amounts paid by the United States to certain nonresident employees or their beneficiaries. This bill is in substance the same as a draft of proposed legislation submitted by the Treasury Department to the President of the Senate and the Speaker of the House of Representatives in a letter dated March 4, 1959. The Department proposal was prepared in consultation with staff members of the Department of State and the Civil Service Commission.

The purpose of H.R. 135 is to provide tax relief for nonresident alien individuals receiving civil service annuities after retiring from U.S. Government employment abroad. Since such persons are classified as nonresident aliens not engaged in trade or business in the United States, their earnings from such employment are exempt from income tax. Upon retirement, however, that portion of the civil service annuities in excess of the allowances for investment in the retirement fund is subject to the flat rate of 30 percent withholding tax imposed on income derived by a nonresident alien from sources within the United States. We are advised that this situation causes severe hardship in some cases and engenders resentment against the United States for its failure to comply with its contractual obligations to pay retired employees the pension they had been led to expect. It is understandable that nonresident alien employees abroad consider their pensions as deferred compensation and feel that since their earned income was not subject to U.S. tax during employment, it is inequitable to tax any portion of the annuity derived from such employment. It is believed that this objective may be satisfactorily accomplished by providing prospectively for exemption from income tax of civil service annuities received by a nonresident alien in respect of services performed abroad in the employ of the United States.

For the above reasons, the Treasury Department favors enactment of H.R. 135.

The Bureau of the Budget has advised the Treasury Department that it has no objection to the submission of this proposed legislation to the Congress.

Sincerely yours,

JAY W. GLASMANN,  
*Assistant to the Secretary.*

U.S. CIVIL SERVICE COMMISSION,  
*Washington, D.C., January 18, 1960.*

HON. HARRY F. BYRD,  
*Chairman, Committee on Finance,*  
*U.S. Senate, New House Office Building.*

DEAR SENATOR BYRD: The Commission has your request for a report on H.R. 135, a bill to amend the Internal Revenue Code of 1954 to exclude from gross income amounts paid by the United States to certain nonresident alien employees or their beneficiaries.

Under instructions from the Internal Revenue Service, the Commission withholds from taxable annuities of nonresident aliens retired under the Civil Service Retirement Act the necessary tax increments required by the Internal Revenue Code. The bill would restrict the cases in which such withholdings would be required for taxable years beginning on or after January 1, 1959. Under it the typical nonresident alien who worked only abroad for the United States would not be subject to Federal tax as regards his annuity.

There being involved only a tax matter within the jurisdiction of the Treasury Department, that Department should make policy recommendation as to the bill's merits. As indicated in House Committee Report 980, the Treasury Department urged favorable consideration of the legislation prior to its passage by the House of Representatives. Its passage will affect the Commission only by lessening its workload in regard to the tax withholdings.

The Commission, while not being in position to comment on the bill's merits, has no objection to its enactment.

The Bureau of the Budget advises that there would be no objection to the submission of this report to your committee.

By direction of the Commission:

Sincerely yours,

ROGER W. JONES, *Chairman.*

## CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

## INTERNAL REVENUE CODE OF 1954

## SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

## (a) TAXABILITY OF BENEFICIARY OF EXEMPT TRUST.—

(1) GENERAL RULE.—Except as provided in [paragraph (2),] paragraphs (2) and (4), the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities) except that section 72(e)(3) shall not apply. The amount actually distributed or made available to any distributee shall not include net unrealized appreciation in securities of the employer corporation attributable to the amount contributed by the employee. Such net unrealized appreciation and the resulting adjustments to basis of such securities shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(2) CAPITAL GAINS TREATMENT FOR CERTAIN DISTRIBUTIONS.—In the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after his separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not includible in gross income, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months. Where such total distributions include securities of the employer corporation, there shall be excluded from such excess the net unrealized appreciation attributable to that part of the total distributions which consists of the securities of the employer corporation so distributed. The amount of such net unrealized appreciation and the resulting adjustments to basis of the securities of the employer corporation so distributed shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(3) DEFINITIONS.—For purposes of this subsection—

(A) The term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form.

(B) The term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as

defined in section 421(d)(2) and (3)) of the employer corporation.

(C) The term "total distributions payable" means the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death or other separation from the service, or on account of his death after separation from the service.

(4) *DISTRIBUTIONS BY UNITED STATES TO NONRESIDENT ALIENS.*—The amount includible under paragraph (1) or (2) of this subsection in the gross income of a nonresident alien individual with respect to a distribution made by the United States in respect of services performed by an employee of the United States shall not exceed an amount which bears the same ratio to the amount includible in gross income without regard to this paragraph as—

(A) the aggregate basic salary paid by the United States to such employee for such services, reduced by the amount of such basic salary which was not includible in gross income by reason of being from sources without the United States, bears to

(B) the aggregate basic salary paid by the United States to such employee for such services.

In the case of distributions under the Civil Service Retirement Act (5 U.S.C., sec. 2251), the term "basic salary" shall have the meaning, provided in section 1(d) of such Act.

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SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

(a) NO UNITED STATES BUSINESS AND GROSS INCOME OF NOT MORE THAN \$15,400.—\* \* \*

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(b) NO UNITED STATES BUSINESS AND GROSS INCOME OF MORE THAN \$15,400.—\* \* \*

\* \* \* \* \*

(c) UNITED STATES BUSINESS.—\* \* \*

\* \* \* \* \*

[(d) DOUBLING OF TAX.—

【For doubling of tax on citizens of certain foreign countries, see section 891.】

(d) *CROSS REFERENCES.*—

(1) For doubling of tax on citizens of certain foreign countries, see section 891.

(2) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4)

