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INCLUSION OF MEDICAL, ETC., BENEFITS UNDER QUALIFIED PENSION PLANS

OCTOBER 2 (legislative day, OCTOBER 1), 1962.—Ordered to be printed

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

REPORT

[To accompany H.R. 10117]

The Committee on Finance, to whom was referred the bill (H.R. 10117) to amend section 401 of the Internal Revenue Code of 1954 to provide that plans which provide certain medical and other benefits for retired employees and their families may be qualified pension plans, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF BILL

Your committee has accepted the House provision without change but has added a new provision to the bill.

H.R. 10117, as passed by the House, would allow a pension plan, qualified under the Internal Revenue Code of 1954, to provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees and their spouses and dependents, if such benefits are subordinate to the retirement benefits provided by the plan.

Under the committee amendment, a taxpayer who has not exercised an option within the time prescribed by regulation to treat intangible drilling and development expenditures in connection with oil and gas wells as expenses for Federal income tax purposes would be granted a new option to do so, to be exercised not later than December 31, 1962. The option, if exercised, would apply for the first taxable year ending after the date of enactment of this bill and would be binding for all subsequent years in the same manner and to the same extent as if it had been made under appropriate Treasury regulations.

II. INCLUSION OF MEDICAL, ETC., BENEFITS UNDER QUALIFIED PENSION PLANS

The system of providing for the pension needs of workers through qualified employer pension plans has become an important feature of the American scene. It has also become common to provide medical benefits through employer contributions to an insurance plan for employees. In both situations, under present law, if certain conditions are met, the employer may receive a tax deduction for contributions to a pension plan or to an insurance plan and these contributions are not currently includible in income of the employee in the case of pension plans and are not includible in income at all (subject to the limitation in sec. 105) in the case of medical expense insurance. This tax treatment has had a considerable effect on the growth of both types of plans.

A number of employers have provided, under their sickness and accident policies for employees, a continuation of benefits after the employee retires. Since the employee must earn his entitlement to such benefits during his working years, it is often desirable that the sickness and accident insurance to which an employee will be entitled after retirement be funded during the working years in the same way that the employer might fund the employee's pension rights. From the standpoint of the employer, it may be more efficient to fund the pension and insurance programs together in a single qualified plan in order to reduce administrative expenses. The present language of section 401 of the Internal Revenue Code of 1954, however, has been interpreted as making a pension plan which provides other than pension benefits nonqualified, and thus the employer would lose his deduction for amounts contributed. Various other tax advantages of a qualified pension plan would also be lost. This means that under present law employers must incur the added expense of setting up a separate fund, with trustees, etc., to provide for the medical expenses of their retired employees.

This provision would make it possible, where an employer chooses to do so, to provide the medical, etc., benefits through a qualified pension plan rather than being required to do so separately, as under existing law.

This provision provides that where such benefits are included in a pension plan the employer must allocate his total contributions to two separate accounts, one being used to fund pension benefits and the other being used to fund medical benefits. The employer contributions to the medical benefit account must be reasonable and ascertainable. No part of the fund maintained to pay medical benefits may be used at any time to pay pension benefits. These requirements are necessary in order to preserve the limitations in section 404 dealing with the amount of the employer pension contribution that may be deductible.

The medical benefits that might be covered for retired employees include the same type of benefits that can be provided now in a plan under section 105. This includes benefits for sickness, accident, hospitalization, and medical expenses of the character described in section 213 of the Internal Revenue Code as they relate to the retired employee, his spouse, or dependents. The bill would be effective for taxable years beginning after the date of its enactment.

It is estimated that the revenue loss under this provision would be negligible since the purpose of the provision is essentially to simplify administration of such benefits.

III. NEW ELECTION FOR EXPENSING INTANGIBLE DRILLING AND DEVELOPMENT COST

Under regulations issued by the Treasury Department an operator or other taxpayer who holds working or operating rights in oil or gas properties, and who pays or incurs intangible drilling and development costs in connection with those properties may, at his option, treat such costs as expenses, which for Federal income tax purposes are deductible currently. This option must be exercised on the tax return for the first taxable year in which the taxpayer pays or incurs intangible drilling and development expenditures. Once exercised the option is binding upon the taxpayer for the first taxable year for which it is made and for all subsequent taxable years. If the option is not properly exercised—that is, if it is not made on the tax return for the first taxable year for which intangible drilling and development expenditures are paid or incurred—it may not, under the regulations, be made in a later year, and the taxpayer must capitalize such expenditures and amortize them over the life of the oil or gas well.

Expenditures to which this option applies include all expenditures made by an operator for wages, fuel, repairs, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas. Examples of these expenditures include costs paid or incurred for the drilling, shooting, and cleaning of wells; in such clearing of ground, roadmaking, surveying, and geological work as are necessary in preparation for the drilling of wells; and in the construction of derricks, tanks, pipelines, and other physical structures necessary for the drilling of wells and the preparation of wells for the production of oil or gas.

The attention of your committee has been called to situations where, through oversight, the option to deduct intangible drilling and development costs was not exercised within the time specified in the regulations with the result that some taxpayers have been placed at a considerable disadvantage as compared to competing oil and gas producers. Because the Treasury regulations issued pursuant to section 263(c) of the Internal Revenue Code of 1954 do not permit a taxpayer who failed to exercise a binding option for the first taxable year for which he paid or incurred intangible drilling and development expenditures to do so with respect to any subsequent taxable year, and in view of the competitive situation which follows a failure to exercise a binding option, your committee believes it appropriate to provide a second chance to elect to expense such costs.

For this reason, in the case of a taxpayer who may not exercise an option under the appropriate Treasury regulations (Regs. sec. 1.612–4, Internal Revenue Code of 1954), your committee's amendment grants a new option to treat intangible drilling and development expenditures with respect to oil and gas wells as expenses which are deductible currently for Federal income tax purposes. Under the amendment this option must be exercised on or before December 31, 1962. An option under the committee amendment will apply with respect to the first taxable year of the taxpayer ending on or after

the date of the enactment of this bill. If an option is exercised under this provision it is to be binding on the taxpayer in the same manner and to the same extent as if it had been made under the appropriate regulations of the Treasury Department.

IV. DEPARTMENTAL REPORT

TREASURY DEPARTMENT,
Washington, September 24, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

MY DEAR MR. CHAIRMAN: This is in reference to H.R. 10117, a bill to amend section 401 of the Internal Revenue Code of 1954 to provide that plans which provide certain medical and other benefits for retired employees and their families may be qualified pension plans.

This bill would allow a pension plan qualified under the Internal Revenue Code to provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees and their spouses and dependents, provided that such benefits are subordinate to the retirement benefits provided by the plan and that certain specified requirements are met which are designed to keep separate the funds contributed for the two types of benefits. At present, a qualified pension cannot provide for the payment of the benefits covered by the bill. The income tax regulations specifically state that a plan is not a pension plan if it provides for the payment of benefits not customarily included in a pension plan, such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses.

It is important to note that, although an employer may not now provide medical benefits to his retired employees and their families through the medium of a qualified pension trust, he can make such benefits available through the use of a separate plan with no less tax advantage to himself or to his retired employees. For example, while contributions which an employer makes toward the purchase of medical and other related benefits for his employees are not deductible under section 404 of the Internal Revenue Code relating to deductions for contributions to pension plans, they are fully deductible under section 162 of the code as ordinary and necessary business expenses. Similarly, under section 106 of the code, employer contributions for medical benefits are not includible in the gross income of their employees. In addition, under section 501(c)(9) of the code, voluntary employees' beneficiary associations which pay life, sick, accident, or other benefits to members or their dependents are exempt from taxation, providing that no part of the net earnings other than normal payments inures to the benefit of any private shareholder or individual and 85 percent or more of the association's income comes from employer or employee contributions.

It is apparent, therefore, that present law already grants separate plans providing employer-financed medical benefits favorable tax treatment comparable to that which would be accorded if such plans could be incorporated in qualified pension plans under the proposed legislation. However, allowing pension and medical care benefits for employees to be provided under a single trust instead of under two separate trusts might make possible a slight decrease in the costs of establishing and administering plans providing such benefits.

Although no substantial benefit to employers or employees is apparent in the proposed legislation, the Treasury Department has no objection to the enactment of H.R. 10117.

The Bureau of the Budget has advised the Treasury Department that there is no objection from the standpoint of the administration's program to the presentation of this report.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

V. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).