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RUSSELL B. LONG, *Chairman*

PART 8

SOCIAL SECURITY-MEDICARE TAX-RELATED PROBLEMS

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I. RETIREMENT INCOME CREDIT

Present Law

Present tax law provides a tax credit for persons who are retired under a public retirement system, or who are 65 years of age or older, on taxable retirement income which they receive. Because social security and railroad retirement benefits are tax-exempt, the retirement income credit was designed to provide approximately equal tax treatment for taxpayers that receive retirement income in a form other than social security and railroad retirement.

Problem

When the retirement income credit was enacted into law in 1954, the maximum amount of retirement income which could qualify for the credit ($1200) was equal to the annual maximum amount which could be received in social security benefits. Similarly, the amount of non-retirement income which could be received without reduction of the tax credit was approximately equal to the amount of non-retirement income which could be received by recipients of social security without a reduction in social security benefits. Although social security benefits were subsequently increased, the maximum amount of retirement income available for the credit was not changed until 1962. In 1962, the maximum limit of the credit for an individual was increased to correspond with the maximum social security benefits enacted in 1958. In 1964 a corresponding increase in the maximum limit of the credit was provided for married couples. Thus, the present maximum retirement income limits for a single person are $1,524 and $2,286 for a married couple. Under these limits, the maximum tax savings for a single person is $228.60 and $342.90 for a married couple.

Alternatives for Committee consideration

1. *Treasury position.*—The Treasury Department recommends that any action on an increase in the retirement income credit be deferred at this time. The Department is presently preparing a report on the results of a study of the taxation of all retirement and pension income and plans to present their recommendations next spring for Congressional consideration.

2. *S. 2968.*—Senator Ribicoff has introduced a bill, S. 2968, which would increase the limit used in computing the retirement income credit for a single individual from $1,524 to $1,872. The maximum amount which would be used by a married couple would be increased from $2,286 to $2,808. Thus, the maximum tax saving for a single person would be increased to $280.80 and $421.20 for a married couple.

Also, the bill provides that the present $1,200 limit in the amount of earned income which can be received without a reduction in the amount of the credit would be increased to $1,680 and the dollar for dollar reduction occurring after $1,700 of earned income has been received would be increased to $2,880. These amounts correspond with the maximum social security benefits and earnings limitations

which applied before the increase enacted as part of the 1969 Tax Reform Act. The revenue costs of this proposal would be $85 million annually.

3. *S. 4345.*—Senator Harrison Williams has introduced a bill, S. 4345, which provides that the maximum limit to be used in computing the retirement income credit would be increased to $2,278 for a single individual and to $3,417 for a married couple. The amount of earned income which could be received before a reduction of the credit would be the same as that under Senator Ribicoff's bill, S. 2968. The credit limitations proposed by the bill correspond with the maximum social security benefits enacted in the Tax Reform Act of 1969. Under this proposal, this maximum tax saving for a single person would be $341.70 and $512.55 for a married couple. The revenue cost of this increase would be $165 million annually.

4. *Average Social Security Payments.*—Another way of increasing the maximum limit of the retirement income credit would be to relate it to what is believed will be the average (rather than the maximum) social security payment to be made under the ten percent—$100 monthly minimum increases recently adopted by the Committee. The average payments for a single individual are expected to be $1,584 annually, and $2,676 annually for a married couple. Under these limitations, the maximum tax saving for an individual would be $237.60 and $401.40 for a married couple. The revenue cost of this proposal is estimated to be $25 million annually.

5. *Maximum Increase.*—If the Committee wishes to consider increasing the maximum amount of retirement income available for the credit to the maximum annual amounts which a social security recipient may receive under the 10 percent increase recently adopted by the Committee, the maximum limit on retirement income for a single individual would be $2,506 and $3,759 for a married couple. The limits would provide a maximum tax saving for a single individual of $375.90 and $563.85 for a married couple. The revenue cost of this proposal would be $200 million annually.

II. EXEMPTION FOR RELIGIOUS SECTS

Present Law

Under present law, since the Social Security Act of 1965, members of certain religious sects, who have conscientious objections to social security by reasons of their adherence to the established tenets or teachings of the sect, may be exempt from the self-employment tax provided they also waive their eligibility for social security benefits. This provision was written largely to relieve the Old Order Amish of having to pay the social security tax when because of their religious beliefs they would never draw social security benefits.

Problem

The 1965 amendment applied only to members of a religious sect who were self-employed; it did not apply to members of the same sect who work as employees. The report of the Finance Committee in 1965 makes clear that this distinction was intended. It reads in part:

> "The proposed exemption would be limited to the self-employment tax under social security since those persons for whom the payment of social security taxes appears to be irreconcilable with

their religious convictions also, by reason of their religious beliefs, limit their work almost entirely to farming and to certain other self-employment."

Proposal

In the interval since the 1965 amendment was enacted an increasing number of members of the Amish sect work as employees. To some extent this is a result of the unavailability of farm land in areas where they reside. In large measure, in the past, the Amish have confined their labors to agricultural pursuits.

In recognition of the changing pattern of employment it is suggested that the Committee consider a modification along the lines of amendment No. 949 introduced by Senator Schweiker. This amendment would free employees of the social security tax under the same rules that presently apply to the self-employed.

Under these rules the individual would have to file:

(1) An application for exemption from tax; and

(2) a waiver of eligibility for social security and Medicare benefits.

In addition, the Secretary of Health, Education, and Welfare would have to make a finding that:

(1) The religious sect to which the individual belongs conscientiously opposes the acceptance of benefits under any private or public insurance plan;

(2) it is the practice in that sect to make provision for the dependent families which is reasonable in view of their general standard of living; and

(3) the sect has been in existence at all times since December 31, 1950.

There would be no forgiveness of the employer portion of the tax, however, since this would create an undesirable preference in the statute by relieving an employer of tax on the basis of the religious belief of his employees.

III. REQUIRED INFORMATION FOR EXCESS MEDICARE TAX CREDITS OR REFUNDS

Present Law

Under present law as provided by the Social Security Amendments of 1967, a railroad employee or railroad representative whose work is covered by railroad retirement and who is also employed in other work covered by Social Security is entitled to receive a credit or refund of his excess Medicare tax he may have paid because of this dual employment status. To inform an employee of his compensation covered by railroad retirement and the hospital tax deducted from it, the 1967 Amendments required railroads to include on the W-2 forms (which must be furnished to employees by January 31 of each year), the amount of wages paid subject to railroad retirement and the portion of the tax attributable to hospital insurance (Medicare). With this information it was presumed that he would be aware of his refund rights and thereby claim them *as a credit* on his return.

Problem

The present information requirement cannot readily be complied with by the railroads in time to meet the January 31 date. The rail-

road's inability to furnish this information by January 31 results from a broader wage concept under railroad retirement, in contrast to compensation for Federal income tax purposes. Due to the adjustments required in arriving at railroad retirement compensation (which is determined on a monthly basis for any year), more time is required, and the January 31 date does not provide sufficient amount. Also, railroads cannot identify the relatively few employees who might be eligible for this refund benefit and thus must necessarily supply the information on the W–2 to all their employees, which number 580,000.

Proposal

It is suggested that the present provision of law requiring railroads to supply separate hospital tax information on the W–2 be deleted and in lieu thereof there be substituted a new requirement that railroad employers include notification on the W–2 form alerting a "dual employed" person to his right to a credit or refund of any excess Medicare tax which he might have paid because of employment under both social security and railroad retirement. In addition to this statutory requirement, the Committee report should include language to the effect that upon request of his employer an employee will be furnished the necessary railroad retirement compensation and hospital tax information by his employing railroad, to enable him to compute the amount, if any, of his tax credit or refund.

IV. DENIAL OF TAX DEDUCTION WITH RESPECT TO CERTAIN MEDICAL REFERRAL PAYMENTS

Present Law

As a result of the 1969 Act, present law provides that no tax deduction is to be available for illegal bribes or kickbacks paid where, as a result of the payments, there is successful criminal prosecution. If the bribe or kickback does not constitute a criminal act (apparently even if there is a loss of license), or if the taxpayer is not successfully prosecuted, a deduction is available.

In 29 States, medical referral payments are not illegal and, therefore, are clearly deductible under present law. In the remaining 21 States, medical referral fees by physicians are classified as constituting unprofessional conduct and are grounds for revocation of licenses to practice medicine.

The pre-1969 law did not generally state that bribes and kickbacks were not deductible. However, the courts, in effect, denied deductions for payments which were held to be contrary to "public policy." In 1952, the Internal Revenue Service ruled that medical referral payments were generally deductible if they did not "frustrate sharply defined National or State policies evidenced by a governmental declaration proscribing particular types of conduct." While what constituted "public policy" was by no means a settled matter, it is likely that if a State were to revoke a license to practice medicine because of the payment of a medical referral fee, the payment would have been held by the courts to be contrary to public policy. As a result, it is quite possible that in such cases, if the Internal Revenue Service had denied a deduction for a medical referral payment, the courts would have upheld the Service. On the other hand, the courts under pre-1969 law in the *Lilly* case refused to deny a deduction for referral payments

in the case of opticians where the payments, although questionable ethically, were not illegal or grounds for revocation of license.

Problem

The staff doubts that the Finance Committee, when it adopted the provision relating primarily to treble damage payments in the consideration of the 1969 Tax Reform Act, intended to relax the deductibility rules in the case of medical referral payments. There is the additional fact that medical referral payments are considered to be unethical by the American Medical Association.

The difficulty in dealing with this problem lies in the fact that these payments under pre-1969 law, although they may not have been deductible in 21 States, probably were deductible in the remaining 29 States where the payments were not grounds for revocation of the license to practice medicine. Since professional conduct is a matter generally regulated by State law, it seems questionable whether Congress would want by Federal law to make all medical referral payments as a general rule nondeductible.

The Federal Government, however, is directly involved in the field of medical payments to the extent of payments made under either the Medicare or Medicaid programs. Medical referral payments where the compensation is provided by the Federal Government through the Medicaid or Medicare programs could be made criminal acts and, therefore, on this ground would, even under the 1969 Act, not be deductible for tax purposes if there were successful criminal prosecution. In addition it is of course possible to deal with situations where the payments were grounds for revocation of licenses.

Considerations for the Committee

The committee could, if it so desired, deny the deductibility of a substantial number of medical referral payments (sometimes referred to as "kickbacks") by amending the Internal Revenue laws to provide that a deduction may not be taken for a transaction which is illegal under Federal or State law or where the payment could result in the loss of license under State law. Thus, if a medical referral payment is made illegal under the Medicare or Medicaid program, then a deduction could not be taken for the payment, whether or not there had been a successful criminal prosecution. Even though there had been no successful criminal prosecution under the Medicaid or Medicare provision, the Internal Revenue Service could deny a tax deduction if it determines the existence of the medical referral payment. Similarly, if the payment would result in forfeiture of a physician's or attorney's license to practice his profession its deduction would be disallowed.

V. REPORTING OF MEDICAL PAYMENTS

Present Law

Under present law, a person making specified kinds of payments in the course of a trade or business to another person, amounting to $600 or more in a calendar year, must file an information return showing the amounts paid and the name, address, and identification number of the recipient. In November, 1969, the Internal Revenue Service announced a ruling that insurance companies (including those participating in medicare), Blue Cross-Blue Shield organizations, and other

organizations making payments to doctors, dentists, and other providers of medical services must make information returns with respect to these payments. Before that time, payments to providers of medical services ordinarily were not required to be reported on information returns.

Problem

Although organizations making direct payments (often described as "assigned" payments) to providers of medical services are now required to make information returns with respect to these payments, there is no authority under existing law to require the reporting of payments made to the patients themselves ("unassigned" payments), even though in normal circumstances they are paid over to the providers of medical services, or represent reimbursement of earlier payments to providers. The fact that present law does not require reporting of unassigned payments limits the usefulness of the information returns, and it could encourage increased use of unassigned payments in order to avoid reporting.

Proposal

The Treasury Department testified before the Committee and recommended that the reporting requirement be expanded to cover unassigned (indirect) payments, and also that it cover payments to professional service corporations and proprietary hospitals. With respect to these payments, the paying organizations would be required to report not the amount actually paid to the provider of the services, but the amount shown on the bills submitted to it by the patient in support of his claim. The individual bills for the year, with respect to a provider of medical services, would be aggregated and the total amount would be reported by the paying organization on a single information return. The amount paid under assigned claims would be reported separately from the amount billed under unassigned claims.

In order to reduce the number of items that must be handled by the paying organization, the Treasury Department has proposed that individual bills amounting to less than $25 be eliminated in computing the aggregate payments on which reporting is required. During a transitional period this $25 minimum would be higher; for 1972 and 1973 the amount would be $100, and for 1974 and 1975 it would be $50. However, the organization could, if it so elected, aggregate and report all bills whether or not below the minimum amount.

The reporting requirement would apply to all payments above the minimum amount, whether or not they amounted to $600 or more in the calendar year. The paying organization would be required to supply each provider of medical services on which it made an information return a copy of the information return. The reporting requirement would not apply to payments for drugs and other merchandise, or to lump sum payments in settlement of tort claims even though bills of providers of medical services were taken into account in fixing the amount of the settlement.

A further reporting requirement would be imposed on payments (in excess of the minimum) which the recipient is obligated to disburse to other providers.

This proposal is similar to the provision included by the Committee in the Senate version of the Tax Reform Act of 1969, but deleted by

the conferees. The principal differences are that the current proposal (1) requires reporting of bills submitted with respect to unassigned medical payments rather than the payments themselves, (2) substitutes for the $600 minimum on aggregate payments a $25 minimum on individual amounts that must be reported, (3) excludes payments for merchandise and lump sum settlements of tort claims, and (4) it does not require in the statute that the Department of Health, Education, and Welfare employ taxpayer identification numbers (the social security in most cases) in dealing with medical care providers under medicare and medicaid.

VI. ADDITIONAL TAX-RELATED AMENDMENTS

Amendment 949 (Schweiker)

This amendment provides that any employee who is a member of a recognized religious sect in existence at least since 1950, who can show that he is an adherent of established teachings which cause him to conscientiously oppose acceptance of social security benefits (the Amish), may file an application to waive such benefits and be exempt from the employee portion of the social security taxes. The employer who employs him, however, would not be exempt from the employer portion of these taxes.

Amendment 968 (Tydings)

This amendment would relieve fairs of liability from unrelated business income tax where they operate racetracks or other public entertainment activities.