

TAX-FREE STATUS OF SOCIAL SECURITY BENEFITS

MAY 15 (legislative day JANUARY 3), 1980.—Ordered to be printed

Mr. LONG, from the Committee on Finance,
submitted the following

REPORT

[To accompany S. Res. 432]

The Committee on Finance, to which was referred the resolution (S. Res. 432) with respect to taxing social security benefits having considered the same, reports favorably thereon without amendment and recommends that the resolution do pass.

I. SUMMARY

At the present time, social security benefits are totally exempt from Federal income taxes. The Social Security Advisory Council recently made a recommendation to change this tax treatment so as to include one-half of the amount of social security benefits in an individual's taxable income. This resolution would express the sense of the Senate that the 96th Congress will not enact legislation which would change the tax treatment of social security benefits.

II. GENERAL DISCUSSION OF THE RESOLUTION

BACKGROUND OF PRESENT TAX TREATMENT OF BENEFIT

Social Security benefits are not explicitly precluded from taxation by statute, but derive their tax-exempt status from administrative rulings going back to 1938. Preceded by a Supreme Court decision (unrelated to the issue of taxability) in which social security was characterized as being for the "general welfare," Bureau of Internal Revenue rulings in 1938 and 1941 (I.T. 3194, I.T. 3229, I.T. 3447) made social security lump-sum and monthly benefits payments nontaxable.

The reasons behind the 1941 ruling (I.T. 3447) included the following:

1. Following the reasoning of the Supreme Court, the benefits were viewed as being motivated by considerations of the general welfare, and such reasoning including elements necessary to bring the benefits within the scope of the section of the code exempting from taxation "the value of property acquired by gift. . . ."

2. Earlier rulings in 1938 that lump-sum payments made under certain sections of the Social Security Act were not taxable were not questioned when subsequent social security amendments were enacted, thus supporting the argument that Congress expected the tax status to remain unchanged.

3. Subjecting benefit payments to income taxation would tend to defeat the underlying purposes of the Social Security Act.

4. Congressional committee reports indicated that the Social Security Act was intended to attack the problems of insecurity by providing safeguards designed to reduce future dependency.

This reasoning was laid out in a letter from the Commissioner of the Bureau of Internal Revenue appearing in House Ways and Means Committee hearings published in 1954. The Commissioner wrote in part:

Upon a determination that the statute contained no specific prohibition against taxing the benefits and no specific mandate, as such, to tax the benefits, the matter was examined from the standpoint of what might be inherent in the statute as a whole with respect to relieving the benefits from taxation. The problem dealt with in I.T. 3447 was given extended consideration prior to the issuance of that ruling. Some who considered the problem were of the opinion that the payments made under title II of the Social Security Act were taxable as annuities. However, the view that prevailed was that the payments do not constitute taxable income in the hands of the recipients . . . the principal reason for the adoption of this position was that the Supreme Court in *Helvering v. Davis* (1937) (301 U.S. 619, 640), characterized the payments made in aid of the general welfare. . . .

In arriving at the conclusion set forth in I.T. 3447 consideration was also given to the fact that in 1938 the Bureau had ruled that lump-sum payments under certain sections of title II of the Social Security Act were not taxable in the hands of the recipients. In this connection see I.T. 3194, C.B. 1938-1, 114 and I.T. 3229, C.B. 1938-2, 136. The proponents of the position taken in I.T. 3447 suggested that since the Congress was aware of the Bureau's published position, and since it appeared that no changes were made in the law by the Social Security Act amendments of 1939 that directly affected the Bureau's published position, it could reasonably be assumed that the Congress expected the Bureau's position to remain unchanged.

Another factor that was given some weight was that if the benefit payments were subjected to the income tax it would tend to defeat the underlying purposes of the Social Security Act.

The Congressional committee reports in connection with the social security amendments of 1939 indicate that the Social Security Act was intended to attack the problems of insecurity by providing safeguards designed to reduce future dependency.

The 1941 ruling remains the basis for the tax-exempt status of OASDI benefits.

REPORT OF THE 1979 SOCIAL SECURITY ADVISORY COUNCIL

In its report on "Social Security Financing and Benefits," the 1979 Advisory Council on Social Security stated that "The council believes that this (1941) ruling was wrong when made and is wrong today. The right to social security benefits is derived from earnings in covered employment just as is the case with private pensions."

A majority of the council recommended that half of social security benefits be included in taxable income for purposes of Federal income taxes.

In support of its recommendations, the Advisory Council cited estimates by the Social Security actuary indicating that workers now entering covered employment in aggregate will make payroll tax payments totaling no more than 17 percent of the benefits that they can expect to receive. "Therefore, if social security benefits were accorded the same tax treatment as private pensions, only 17 percent of the benefit would be exempt from tax when received, and 83 percent would be taxable." The report notes, however, that because of a lack of data, taxing social security in the same way as private pensions "would be quite complicated. It would also result in taxing more of the benefit than most people would consider appropriate. Rough justice would be done, however, if half the benefit . . . were made taxable."

The report also noted that some members of the Advisory Council believe that taxation of benefits should not begin immediately and that some kind of gradual phase-in should be provided. Other members, according to the report, support the recommendation only if coupled with the adoption of other council recommendations. Three members of the council provided a supplementary statement expressing concern that this and other recommendations were adopted without adequate information for making an informed judgment as to their impact.

ESTIMATED REVENUES UNDER THE ADVISORY COUNCIL RECOMMENDATION

Based on 1978 data, the Advisory Council estimated that its proposal for taxing half of social security benefits would affect 10.6 million tax filing units (with the highest taxable incomes) of the 24.2 million who received social security cash benefits in that year. The average tax increase for those tax units which had an increase would be about \$350, and the total increase in Federal tax collections would be \$3.7 billion.

COMMITTEE RESOLUTION

Since the social security program was initiated, there have from time to time been proposals such as that of the Advisory Council for modifying the tax treatment of benefits. The Committee has never approved such proposals in the past and it is the judgment of the

Committee that it will not approve any such proposals now. To assure that undue concern on the part of beneficiaries is not created by the Advisory Council recommendation, the Committee has reported this resolution which will affirmatively state that it is the sense of the Senate that no such change in the tax treatment of social security benefits will be approved by the 96th Congress.

III. VOTE OF THE COMMITTEE IN REPORTING THE RESOLUTION

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote by the committee to report the resolution.

The resolution was ordered reported by a rollcall vote as follows:
Yeas (17) : Senator Long, Talmadge, Ribicoff, Byrd, Nelson, Gravel, Matsunaga, Baucus, Boren, Bradley, Dole, Packwood, Roth, Chafee, Heinz, Wallop, and Durenberger.

Nays (0).

