

LIMITATION ON RETIREMENT INCOME CREDIT

SEPTEMBER 29, 1962.—Ordered to be printed

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

R E P O R T

[To accompany H.R. 6371]

The Committee on Finance, to whom was referred the bill (H.R. 6371) to amend section 37 of the Internal Revenue Code of 1954 with respect to the limitation on retirement income, having considered same, report favorably thereon without amendment and recommend that the bill do pass.

I. SUMMARY

The retirement income credit under present law is designed to give those who have retirement income, but do not receive tax-exempt social security or similar types of tax-exempt benefit payments, a tax exemption of approximately the same size as that received by social security beneficiaries. Although at one time the terms of the retirement income credit corresponded approximately with those of the social security benefits, as changes have been made in the social security program corresponding changes have not always been made in the retirement income credit. This bill updates the credit in this respect, first by raising the maximum amount of retirement income which may be taken into account from \$1,200 to \$1,524 (as under present law this will continue to be multiplied by the first bracket tax rate of 20 percent to determine the credit). Second, instead of earned income in excess of \$1,200 reducing the retirement income eligible for the credit on a dollar-for-dollar basis, such a dollar-for-dollar reduction will occur only for earnings above \$1,700. For earnings between \$1,200 and \$1,700, the retirement income will be reduced by 50 cents for every dollar of earnings. Third, for those retiring under public retirement programs, this new reduction for earned income will apply to those age 62 or over rather than 65 or over as under present law. (For those under a public retirement program below age 62, the present \$900 floor for a reduction arising from earned income will continue to apply.)

II. GENERAL STATEMENT

In 1954 Congress added to the tax laws the retirement income credit. As indicated in the report made on the bill at that time the credit was added because—

Under existing law benefits payable under the social security program and certain other retirement programs of the Federal Government are exempt from income tax. Your committee believes that the tax-exempt status of such benefits discriminates against persons receiving retirement pensions under other publicly administered programs, such as teachers, as well as against persons who receive industrial pensions or who provide independently for their old age.

In view of this situation, Congress provided a credit against tax which in effect allowed an exemption of retirement income (at the first tax bracket rate) patterned along the lines of the social security benefits then payable, but available to individuals only to the extent that they do not receive social security, railroad retirement, or other similar tax-exempt forms of income.

Because this credit was designed in effect to give those not receiving social security, railroad retirement, and other forms of tax-exempt income tax exemption on their passive investment income to the same extent as those receiving social security benefit payments, any of the salient features of the credit were designed along the lines of the social security program.

The forms of retirement income eligible for this credit are pensions and annuities, interest, rents, and dividends.

In addition to the retirement income credit generally available, such a credit, subject to added restrictions as to earnings, was also made available in 1954 to those under age 65 receiving income from pensions and annuities under a public retirement system.

Since the last amendments to the retirement income credit in 1956, there have been a number of changes made in the social security program. As a result, the retirement income credit no longer provides equal tax treatment for those who may be retired under Government or private pension systems or may make provision through investment income for their own retirement. This bill is designed to remove this discrimination which has arisen gradually as changes have been made in the social security program without corresponding changes in the retirement income credit.

To again equalize the retirement income credit with the social security program, three changes are made:

First, the maximum amount of income which may qualify as retirement income is raised from \$1,200 to \$1,524 a year. This latter figure corresponds exactly with the maximum primary benefit (\$127 a month) now available under the social security program. To determine the maximum retirement income credit, the \$1,524 must be multiplied by 20 percent. Thus there will be a maximum credit of \$304.80 per person under the bill as contrasted to \$240 under present law.

Second, the reduction made in the retirement income credit for earned income is changed to correspond with the changes made in the earned income reduction provided by the Social Security Amendments of 1960 and 1961. Thus, instead of all earnings above \$1,200

reducing the amount eligible for the retirement income credit on a dollar-for-dollar basis, earnings between \$1,200 and \$1,700 a year are to reduce the retirement income credit by a half dollar for every dollar of earnings in this bracket. For income above \$1,700, there will still be the dollar-for-dollar reduction.

Third, because of the change in the social security age requirement from 65 to 62, for those retired under public retirement systems who are in the age bracket 62 to 65, the level of earned income where the reduction in retirement income begins is increased from the \$900 level provided by present law to \$1,200, with the one-half-for-one reduction in the bracket between \$1,200 and \$1,700 referred to above.

The eligibility age for the retirement income credit generally, was not reduced from 65 to 62 because, although it is now possible for men to retire at this age under the social security program, they are not at that time eligible for the full social security benefit payments.

The changes made by the bill can be illustrated by an example. Assume an individual between ages 65 and 72 receives \$2,000 from dividends, interest, and a pension provided exclusively by his employer. Assume further that he receives \$1,800 from working in a part-time job. Assume also that he had earnings of more than \$600 in each of 10 prior years. In this case his retirement income credit under present law and under this bill can be computed as follows:

	Present law	Committee bill
1. Retirement income to be taken into account: \$1,200 under present law or \$1,524 under bill or actual amount (\$2,000 in this case) whichever is less	\$1,200	\$1,524.00
2. Less earned income over \$1,200 under present law or under bill $\frac{1}{2}$ of earnings between \$1,200 and \$1,700 and all earnings over \$1,800 (present law=\$1,800-\$1,200; bill= $\frac{1}{2}$ of earnings between \$1,200 and \$1,700 plus the \$100 over \$1,700).....	600	350.00
3. Retirement income eligible for credit.....	600	1,174.00
4. Credit: 20 percent of amount on line 3 ¹	120	234.80

¹ Assumes this is not less than tax as otherwise computed.

It is estimated that the changes made by this bill will result in an annual revenue loss of something like \$30 million a year.

DEPARTMENTAL REPORT

TREASURY DEPARTMENT,
Washington, May 14, 1962.

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

MY DEAR MR. CHAIRMAN: This is in response to a request for the views of this Department on H.R. 6371, to amend section 37 of the Internal Revenue Code of 1954 with respect to the limitation on retirement income.

The retirement income credit was designed, in effect, to give those who have retirement income a tax exemption similar to that received by social security beneficiaries, whose benefits are not considered part of their gross income and are therefore tax exempt. To achieve this purpose, Congress enacted section 37 of the Internal Revenue Code of 1954. This measure allows a retired individual a tax credit, com-

puted at the first bracket rate of 20 percent, on the amount of his otherwise taxable retirement income up to a maximum of \$1,200. The \$1,200 maximum was selected to correspond, roughly, to the maximum primary social security benefit which could be paid at the time. To prevent the duplication of relief, amounts received from nontaxable pensions and annuities, including social security benefits, must be subtracted from the maximum figure before computing the credit. The credit may not exceed the tax liability of the individual.

The retirement income credit, like the social security program, was intended for the benefit of retired persons. Section 37 as first enacted contained essentially the same test of retirement as was then employed for the purpose of social security. The income eligible for credit in the case of persons under 75 was reduced by the amount of earnings in excess of \$900. Section 37 was amended in 1956 so that the earnings limit for the retirement test would conform to the revised limit adopted in the 1954 amendments to the Social Security Act. The age level at which the earnings limitation ceased to apply was lowered from 75 to 72 years, and the dollar level at which the earnings deduction began to take effect for a person between the ages of 65 and 72 was raised from \$900 to \$1,200. For persons under 65 (who must be retired under a public retirement system to qualify for the credit) the dollar level for the earnings limitation remained \$900. The income eligible for credit was reduced by \$1 for each \$1 of earnings in excess of the limits imposed.

H.R. 6371 is designed to amend the provisions of the retirement income credit to conform to the changes made in recent years by amendments to the Social Security Act. For taxable years ending after its enactment, the bill would increase the maximum amount of income eligible for credit from \$1,200 to \$1,524. The new figure is the annual equivalent of the maximum primary social security benefit of \$127 a month established in the 1958 amendments to the Social Security Act.

The bill would also liberalize the present earnings limitation. As a result, people between the ages of 65 and 72 would no longer lose \$1 of income eligible for the credit for each dollar of earnings in excess of \$1,200; rather they would lose \$1 for every \$2 of earnings in excess of \$1,200 but not in excess of \$1,700. Earnings in excess of \$1,700 would continue to reduce the income eligible for the credit on a dollar-for-dollar basis.

The new liberalized earnings limitation described above would also apply to individuals between the ages of 62 and 72 who are retired on a pension received from a public retirement system. Individuals under 62 who are retired on such pensions would not be eligible for the liberalized earnings limitation; instead they would continue to be subject to the limitation under the present law which reduces the amount of their retirement income eligible for the credit on a dollar-for-dollar basis for any earned income in excess of \$900.

It is estimated that the enactment of this bill would cause a revenue loss of \$40 million.

In the words of the House report accompanying H.R. 6371, Congress designed the retirement income credit, "to give those who have retirement income, but do not receive tax-exempt benefit payments, a tax exemption of approximately the same size as that received by social security beneficiaries." However, as the level of social security

benefits increases, it is necessary to examine the adequacy of the method selected for achieving this objective.

The maximum primary social security benefit of \$1,524 is not a proper benchmark for the purpose of the retirement income credit, since it does not represent the amount received by the average social security beneficiary. Virtually no one under the social security system today receives the maximum primary benefit. In fact, at the end of 1960, the average social security benefit received by retired-worker families was only \$1,014. Because the social security primary benefit amount is based upon the maximum earnings base of \$4,800 that was established in 1958, very few persons will even become eligible for the maximum benefit before 1963. Even when the \$1,524 benefit becomes possible, the average level of benefits will, of course, be far below that amount.

Thus, under the provisions of H.R. 6371, individuals with sufficient retirement income would be able to exempt from tax a sum greater than the nontaxable benefits received by practically all social security beneficiaries. Moreover, married couples would be able to claim a double credit, provided both qualified, which would raise their income eligible for credit to \$3,048. Data are not available on social security benefits received by married couples where each spouse is receiving benefits based on his own earnings. However, in 1960 the sum of the average benefits received by eligible male and female workers amounted to \$1,676—considerably less than the \$3,048 possible credit base under the bill.

The full benefits provided under H.R. 6371 would be available to only a limited number of taxpayers with substantial retirement incomes. According to the 1960 Census of Population, there were 16.6 million people aged 65 or over in that year. Only 46 percent of these, an estimated 7.7 million filed tax returns in 1960; of those filing returns an estimated 3.8 million or 49 percent filed nontaxable returns. Only 2.7 percent of the people 65 or over, an estimated 451,539 persons, claimed the retirement income credit on taxable 1960 returns. For the 273,000 older persons currently claiming the credit on nontaxable returns a larger base for credit would, of course, be of no value. It is estimated that increasing the credit under provisions of the bill would benefit only between 100,000 and 150,000 aged persons.

While the bill would not aid those with low retirement incomes, it would help those with large retirement incomes. A married couple able to use a double credit could reduce their tax bill by as much as an additional \$129.60 under the provisions of this bill. This would raise to \$7,000 the amount such a couple could receive free of tax if they are both over 65 and their earnings entirely from dividends. Few persons 65 or over have incomes of this magnitude; the median 1960 income for families with a head 65 years of age or over was only \$2,897.

The bill would also benefit persons who must now reduce their base for credit as a consequence of their substantial earnings. It would provide persons earning more than \$1,200 but less than \$2,974 with a greater tax credit for their retirement income than they now receive. This effect appears to be inconsistent with the retirement objective of the credit.

The bill would also benefit persons now receiving social security or railroad retirement benefits in addition to their other retirement

income. An increase in the limit from which the amount of such tax-exempt receipts must be subtracted would leave more income eligible for credit than these people may now claim. This effect appears to be inconsistent with the basic intent of the credit, which is to eliminate tax discrimination in favor of persons with social security and other nontaxable pension and annuity income. Furthermore, only a few of the more than 11 million social security and railroad retirement beneficiaries would be able to take advantage of the increased base for credit.

The provisions of H.R. 6371 would give a tax advantage to persons with otherwise taxable retirement income that would be substantially larger than the tax benefits received by the average retired worker receiving social security benefits. This advantage would not be available to the vast majority of retired workers, but only to the relatively small number with substantial retirement income, or with retirement income in addition either to earned income or nontaxable pension or annuity income.

The income and tax status of retired persons and the elderly has been affected in recent years by significant changes in social security, other public retirement programs, and expanding private pension and retirement plans. In the case of social security alone, there have been four major changes made since 1954—in 1956, 1958, 1960, and 1961. The rapidity with which these changes have occurred suggests the desirability of a complete reexamination of the practice of tying provisions of the Internal Revenue Code to the Social Security Act.

As you know, the President has directed the Treasury to undertake the research and preparation of a comprehensive tax reform program. A major aspect of this program will be a broadened and more equitable tax base and reconsideration of the rate structure. We believe that the problem that H.R. 6371 attempts to meet should be considered in connection with such a general tax program. This would permit consideration of the problem in the light of a general examination of issues in both the area of pension and retirement income and the tax treatment of the elderly. Accordingly, the Department recommends that legislation dealing with the retirement income credit be deferred until it can be considered in the perspective of the entire tax reform program. The Treasury Department, therefore, does not favor the enactment of H.R. 6371.

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.

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 are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

SECTION 37 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 37. RETIREMENT INCOME

(a) GENERAL RULE.—In the case of an individual who has received earned income before the beginning of the taxable year, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d)), multiplied by the rate provided in section 1 for the first \$2,000 of taxable income; but this credit shall not exceed such tax reduced by the credits allowable under section 32(2) (relating to tax withheld at source on tax-free covenant bonds), section 33 (relating to foreign tax credit), section 34 (relating to credit for dividends received by individuals), and section 35 (relating to partially tax exempt interest).

(b) INDIVIDUAL WHO HAS RECEIVED EARNED INCOME.—For purposes of subsection (a), an individual shall be considered to have received earned income if he has received, in each of any 10 calendar years before the taxable year, earned income (as defined in subsection (g)) in excess of \$600. A widow or widower whose spouse had received such earned income shall be considered to have received earned income.

(c) RETIREMENT INCOME.—For purposes of subsection (a), the term "retirement income" means—

(1) in the case of an individual who has attained the age of 65 before the close of the taxable year, income from—

- (A) pensions and annuities,
- (B) interest,
- (C) rents, and
- (D) dividends, or

(2) in the case of an individual who has not attained the age of 65 before the close of the taxable year, income from pensions and annuities under a public retirement system (as defined in subsection (f)),

to the extent included in gross income without reference to this section, but only to the extent such income does not represent compensation for personal services rendered during the taxable year.

(d) LIMITATION ON RETIREMENT INCOME.—For purposes of subsection (a), the amount of retirement income shall not exceed **[\$1,200]** \$1,524 less—

(1) in the case of any individual, any amount received by the individual as a pension or annuity—

- (A) under title II of the Social Security Act,
- (B) under the Railroad Retirement Acts of 1935 or 1937, or
- (C) otherwise excluded from gross income, and

(2) in the case of any individual who has not attained [the] age [of] 72 before the close of the taxable [year, any amount of earned income (as defined in subsection (g))] year—

(A) [in excess of \$900 received by the individual in the taxable year if such individual has not attained the age of 65 before the close of the taxable year, or] *if such individual has not attained age 62 before the close of the taxable year, any amount of earned income (as defined in subsection (g)) in excess of \$900 received by such individual in the taxable year, or*

(B) [in excess of \$1,200 received by the individual in the taxable year if such individual has attained the age of 65 before the close of the taxable year.] *if such individual has attained age 62 before the close of the taxable year, the sum of (i) one-half the amount of earned income received by such individual in the taxable year in excess of \$1,200 but not in excess of \$1,700, and (ii) the amount of earned income so received in excess of \$1,700.*

(e) **RULE FOR APPLICATION OF SUBSECTION (d)(1).**—Subsection (d)(1) shall not apply to any amount excluded from gross income under section 72 (relating to annuities), 101 (relating to life insurance proceeds), 104 (relating to compensation for injuries or sickness), 105 (relating to amounts received under accident and health plans), 402 (relating to taxability of beneficiary of employees' trust), or 403 (relating to taxation of employee annuities).

(f) **PUBLIC RETIREMENT SYSTEM DEFINED.**—For purposes of subsection (c)(2), the term “public retirement system” means a pension, annuity, retirement, or similar fund or system established by the United States, a State, a Territory, a possession of the United States, any political subdivision of any of the foregoing, or the District of Columbia.

(g) **EARNED INCOME DEFINED.**—For purposes of subsections (b) and (d)(2), the term “earned income” has the meaning assigned to such term in section 911(b), except that such term does not include any amount received as a pension or annuity.

(h) **NONRESIDENT ALIEN INELIGIBLE FOR CREDIT.**—No credit shall be allowed under subsection (a) to any nonresident alien.

(i) **CROSS REFERENCE.**—

For disallowance of credit where tax is computed by Secretary or his delegate, see section 6014(a).

