MISCELLANEOUS TAX BILLS II

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

S. 869, S. 1674, S. 2128, S. 2393, S. 2462, S. 2628, S. 2825, S. 3007, S. 3037, S. 3080, S. 3125, S. 3301

JULY 24, 1978

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MISCELLANEOUS TAX BILLS II

MONDAY, JULY 24, 1978

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2221, Dirksen Senate Office Building, Hon. Harry F. Byrd, Jr. (chairman of the subcommittee) presiding.

Present: Senators Byrd, Jr., of Virginia, Hathaway, Curtis, Hansen, Dole, Packwood, and Laxalt.

[The committee press release announcing this hearing and the bills S. 869, S. 1674, S. 2128, S. 2393, S. 2462, S. 2628, S. 2825, S. 3007, S. 3037, S. 3080, S. 3125, S. 3301 follows:]

[Press release]

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT ANNOUNCES HEARINGS ON MISCELLANEOUS TAX BILLS

Senator Harry F. Byrd, Jr., (I–Va.), Chairman of the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, announced that a hearing will be held on July 24, 1978, on miscellaneous tax bills.

The hearing will be held on Monday, July 24, 1978, at 9:30 a.m. in Room 2221 Dirksen Senate Office Building.

The following pieces of legislation of general application, unless otherwise noted, will be considered:

S. 869, sponsored by Senator Bartlett, a bill to increase from one million dollars to ten million dollars the exemption from industrial development bond treatment for certain small issues.

S. 1674, sponsored by Senators Laxalt, Cannon, Curtis, and Dole, a bill changing the recordkeeping requirements applicable to employers with respect to tip income of their employees.

S. 2128, sponsored by Senators Inouye, Chiles, Thurmond, Domenici, Durkin, Stone Hathaway, Eagleton, Schmitt, and Dole, a bill to eliminate the adjusted gross income limitation on the credit for the elderly, to increase the amount of the credit, and to create a cost-of-living adjustment.

S. 2393, sponsored by Senator Dole, a bill changing the tax treatment of certain obligations transferred in connection with a corporate organization or reorganization.

S. 2462, sponsored by Senators Dole, Tower, Lugar, Gravel, Hayakawa, Percy, Stevens, Nelson and Curtis and S. 3288 sponsored by Senator Dole bills to permit a limited individual retirement deduction to individuals who are participants in retirement plans.

S. 2628, sponsored by Senator Bumpers, a bill to eliminate the requirement that a husband and wife who live together and claim the disability payments exclusion must file joint returns.

S. 2825, sponsored by Senators Bartlett, Tower, and Javits, a bill to exempt certain organizations from treatment as a private foundation if the principal purpose is to provide long-term care or education of permanently and totally disabled persons, elderly persons, needy widows, or children. This bill would benefit the Sand Springs Home in Oklahoma and approximately 26 other homes around the country.

S. 3007, sponsored by Senators Dole, Curtis, Hatch, Church, Tower, Lugar, Domenici, Gravel Eagleton Schmitt McClure, Thurmond, and Hayakawa, a bill to disregard any IRS changes in the occupational status of any individual, for example, from independent contractor to employee, until Congress acts to amend the Internal Revenue Code.

S. 3037, sponsored by Senators Domenici, Haskell, Johnston Gravel, and Huddleston, a bill to disregard certain IRS Revenue Rulings relating to the status of real estate agents as employees as opposed to independent contractors.

S. 3080, sponsored by Senator Allen, a bill to exclude certain services performed on fishing boats from coverage under the Federal Unemployment Tax Act.

S. 3125, sponsored by Senator Dole, a bill to change the tax treatment of an involuntary conversion of real property to which the special farm valuation provisions of the Federal estate tax apply.

S. 3301, sponsored by Senators Bayh and Chafee, a bill amending Section 1056 of the Internal Revenue Code in circumstances where the transferee of shares of a sports franchise was committed to and did purchase prior to December 31, 1975 more than 50 percent of the voting shares of the transferor. The bill will benefit the New England Patriots Football Club.

Revenue estimates for each of these bills are currently not available. A Committe publication listing each of the bills with revenue estimates will be available prior to or on the day of the hearings.

Requests to Testify.—Persons who desire to testify at the hearing should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on Thursday, July 20, 1978.

Legislative Reorganization Act.—Senator Byrd stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

(1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their five-minute oral presentations to a summary of the points included in the statement.

(5) Not more than five minutes will be allowed for oral presentation.

Written testimony.—Senator Byrd stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by July 31, 1978, to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510.

95TH CONGRESS
1ST SESSION

S. 869

IN THE SENATE OF THE UNITED STATES

MARCH 3 (legislative day, FEBRUARY 21), 1977

Mr. BARTLETT introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to increase from $1,000,000 to $10,000,000 the exemption from industrial development bond treatment for certain small issues.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (6) of section 103 (c) of the Internal Revenue Code of 1954 (relating to exemption from industrial development bond treatment for certain small issues) is amended—

(1) by striking out "$1,000,000" in subparagraph (A) and inserting in lieu thereof "$10,000,000"; and

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(2) by striking out subparagraphs (D), (E), (F), (G), and (H).

(b) The amendments made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act.

95TH CONGRESS
1ST SESSION

S. 1674

IN THE SENATE OF THE UNITED STATES

JUNE 10 (legislative day, MAY 18), 1977

Mr. LAXALT (for himself and Mr. CANNON) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 with respect to employer's duties in connection with the recording and reporting of tips.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 6001 of the Internal Revenue Code of 1954 (relating to notice or regulations requiring records, statements, and special returns) is amended by adding at the end thereof the following: "The only records which an employer shall be required to keep in connection with charged tips shall be charge receipts and copies of statements furnished by employees under section 6053 (a).".

(b) Section 6051 (d) of such Code (relating to state-

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ments to constitute information returns) is amended by adding at the end thereof the following: "Any statement filed with the Secretary pursuant to this section shall constitute, and shall be in lieu of, the information return required to be made under section 6041. The only tips which an employer shall be required to report on any such statement shall be tips which are reflected on statements furnished by employees under section 6053 (a).".

SEC. 2. The amendments made by this Act apply to taxable years beginning after December 31, 1978.

95TH CONGRESS
1ST SESSION

S. 2128

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 22, 1977

Mr. INOUYE introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to eliminate the adjusted gross income limitation on the credit for the elderly, to increase the amount of such credit, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (c) of section 37 of the Internal Revenue Code of 1954 (relating to limitations on credit for the elderly) is amended to read as follows:

"(c) LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed by this section for the taxable year shall not exceed the amount of the tax imposed by this chapter for such taxable year.".

(b) Paragraph (2) of section 37(b) of such Code (defining initial amount) is amended—

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(1) by striking out "$2,500" each place it appears and inserting in lieu thereof "$3,000",

(2) by striking out "$3,750" and inserting in lieu thereof "$4,500", and

(3) by striking out "$1,875" and inserting in lieu thereof "$2,250".

(c) Subsection (b) of section 37 of such Code (relating to section 37 amount) is amended by adding at the end thereof the following new paragraph:

"(4) Cost-of-Living Adjustment.—In the case of any taxable year beginning in a calendar year after 1977, each dollar amount contained in paragraph (2) shall be increased by an amount equal to the product of such dollar amount (without regard to this paragraph) multiplied by the percentage (if any) by which the Consumer Price Index prepared by the Department of Labor for July of such calendar year exceeds such index for July of 1977. If any increase determined under the preceding sentence is not a multiple of $10, such increase shall be increased to the next higher multiple of $10."

(d) The amendments made by this section shall apply to taxable years beginning after December 31, 1976.

95TH CONGRESS
2D SESSION

S. 2393

IN THE SENATE OF THE UNITED STATES

JANUARY 19, 1978

Mr. DOLE introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 357 (c) is amended by the addition of a new paragraph (3) which shall read as follows:

"(3) EXCLUSION AS LIABILITIES.—Solely for purposes of applying paragraph (1) (A), in determining the amount of liabilities assumed or to which the property transferred is subject, there shall be excluded the amount of any obligation to the extent payment thereof by the transferor would have given rise to a deduction allowable under this subtitle or would have constituted

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a payment described in section 736(a). The amount of any such obligation shall not be excludable, however, to the extent that the incurrence of the obligation resulted in the creation of, or an increase in, the basis of any property (as determined under subchapter O of this chapter).".

SEC. 2. Section 358(d) is amended by designating section 358(d) as paragraph (1), and by adding a new paragraph (2) which shall read as follows:

"(2) EXCEPTION.—Paragraph (1) shall not apply to any obligation described in section 357(c)(3).".

SEC. 3. The amendments made by sections 1 and 2 shall apply to transfers occurring on or after the date of enactment hereof.

95TH CONGRESS
2D SESSION

S. 2462

IN THE SENATE OF THE UNITED STATES

JANUARY 31 (legislative day, JANUARY 30), 1978

Mr. DOLE introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to permit a limited individual retirement deduction to individuals who are participants in retirement plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. ALLOWANCE OF DEDUCTION.

(a) DEDUCTION UNDER SECTION 219.—

(1) INDIVIDUALS COVERED BY OTHER PLANS.—Section 219 (b) (2) of the Internal Revenue Code of 1954 (relating to limitations and restrictions on the deduction allowable to individuals covered by certain other plans) is amended to read as follows:

"(2) INDIVIDUALS COVERED BY CERTAIN OTHER

PLANS.—In the case of an individual who, for any part of the taxable year, was covered by another retirement plan, the amount allowable as a deduction under subsection (a) to that individual for the taxable year after the application of paragraph (1) of this subsection shall be reduced by an amount equal to the sum of the amounts contributed by or on behalf of such individual to such plan for the taxable year.".

(2) COVERAGE DEFINED.—Section 219 (c) of such Code (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(5) COVERED BY ANOTHER RETIREMENT PLAN.—For purposes of this section an individual is treated as covered by another retirement plan for the taxable year if for any part of such year—

"(A) he was an active participant in—

"(i) a plan described in section 401 (a) which includes a trust exempt from tax under section 501 (a),

"(ii) an annuity plan described in section 403 (a),

"(iii) a qualified bond purchase plan described in section 405 (a), or

"(iv) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, or

"(B) amounts were contributed by his employer for an annuity contract described in section 403(b) (whether or not his rights in such contract are nonforfeitable).".

(b) DEDUCTION UNDER SECTION 220.—

(1) INDIVIDUALS COVERED BY OTHER PLANS.—Section 220(b)(3) of the Internal Revenue Code of 1954 (relating to limitations and restrictions on the deduction allowable to individuals covered by certain other plans) is amended to read as follows:

"(3) INDIVIDUALS COVERED BY CERTAIN OTHER PLANS.—In the case of an individual who, for any part of the taxable year, was covered by another retirement plan, the amount allowable as a deduction under subsection (a) to that individual for the taxable year after the application of paragraph (1) of this subsection shall be reduced by an amount equal to the sum of the amounts contributed by or on behalf of such individual or his spouse to such plan for the taxable year.".

(c) COVERAGE DEFINED.—Section 220(c) of such Code (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

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"(6) COVERED BY ANOTHER RETIREMENT PLAN.—For purposes of this section an individual is treated as covered by another retirement plan for the taxable year if for any part of such year—

"(A) he or his spouse was an active participant in—

"(i) a plan described in section 401 (a) which includes a trust exempt from tax under section 501 (a),

"(ii) an annuity plan described in section 403 (a),

"(iii) a qualified bond purchase plan described in section 405 (a), or

"(iv) a plan established for its employees by the United States, by a State or political subdivision thereof, or an agency or instrumentality of any of the foregoing, or

"(B) amounts were contributed by his employer for an annuity contract described in section 403 (b) (whether or not rights in such contract are nonforfeitable).".

SEC. 2. REPORTS.

The plan administrator of a plan described herein shall furnish a report to each active participant of such plan who requests such report. The request and the report shall be made at such times and in such manner as the Secretary shall by regulation prescribe. The report shall provide such information as is required by such regulations including the amount of contributions made during the taxable year on behalf of and by such active participant.

SEC. 3. EFFECTIVE DATE.

The amendments made by section 1 of this Act shall apply to taxable years beginning after September 30, 1978.

95TH CONGRESS
2D SESSION

S. 2628

IN THE SENATE OF THE UNITED STATES

MARCH 2 (legislative day, FEBRUARY 6), 1978

Mr. BUMPERS introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To remove a tax incentive for the splitting up of families, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraphs (4) and (6) of subsection (d) of section 105 of the Internal Revenue Code of 1954, as amended by subsection (a) of section 505 of the Tax Reform Act of 1976, Public Law 94–455, approved October 4, 1976, are hereby repealed.

SEC. 2. Paragraphs (5) and (7) of subsection (d) of section 105 of the Internal Revenue Code of 1954, as amended by subsection (a) of section 505 of the Tax Reform Act of 1976, Public Law 94–455, approved October 4, 1976, are hereby renumbered (4) and (5).

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95TH CONGRESS
2D SESSION

S. 2825

IN THE SENATE OF THE UNITED STATES

APRIL 4 (legislative day, FEBRUARY 6), 1978

Mr. BARTLETT introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 with respect to certain charitable contributions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 170(b) (1) (A) (iii) of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following: ", or an organization which on or before May 26, 1969, and continuously thereafter to the close of the taxable year, operated and maintained as its principal functional purpose facilities for the long-term care, comfort, maintenance, or education of permanently and totally disabled persons; elderly persons; needy widows; or children,".

(b) The amendment made by subsection (a) shall take effect on January 1, 1970.

95TH CONGRESS
2D SESSION

S. 3007

IN THE SENATE OF THE UNITED STATES

APRIL 27 (legislative day, APRIL 24), 1978

Mr. DOLE introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To disregard, for purpose of certain taxes imposed by the Internal Revenue Code of 1954 with respect to employees, certain changes since 1975 in the treatment of individuals as employers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That until enactment of any law amending the definition of an employee for purposes of any section of the Internal Revenue Code of 1954, in determining whether an individual is an employee for purposes of sections 3121, 3306, and 3401 of the Internal Revenue Code of 1954, the Internal Revenue Service shall not apply any changed position or any newly stated position which is inconsistent with a general audit position in effect prior to January 1, 1976, or which is inconsistent with a regulation or ruling in effect on December 31, 1975.

95TH CONGRESS
2D SESSION

S. 3037

IN THE SENATE OF THE UNITED STATES

MAY 4 (legislative day, APRIL 24), 1978

Mr. DECONCINI (for himself and Mr. HASKELL) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To provide for the administration of the Internal Revenue Code of 1954 without regard to certain Revenue Rulings relating to the definition of the term "employee".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, the application of sections 3121, 3306, and 3401 of such Code to real estate salespeople shall be determined—

(1) without regard to Revenue Rulings 76–136 and 76–137 (and without regard to any other regulation, ruling, or decision issued on or after December 1, 1975, reaching the same result as, or a result similar to, the result set forth in such Revenue Rulings); and

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(2) with full regard to the rules (including the rules contained in Treasury Mimeograph 6566) in effect before Revenue Rulings 76–136 and 76–137.

95TH CONGRESS
2D SESSION

S. 3080

IN THE SENATE OF THE UNITED STATES

MAY 15 (legislative day, APRIL 24), 1978

Mr. ALLEN introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 to exclude certain service performed on fishing boats from coverage for purposes of unemployment compensation.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3306 (c) of the Internal Revenue Code of 1954 (relating to the definition of employment under the Federal Unemployment Tax Act) is amended—

(1) by striking out "or" at the end of paragraph (17);

(2) by redesignating paragraph (18) as paragraph (19); and

(3) by inserting after paragraph (17) the following new paragraph:

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"(18) service performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

"(A) such individual does not receive any cash remuneration (other than as provided in subparagraph (B)),

"(B) such individual receives a share of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life or a share of the proceeds from the sale of such catch, and

"(C) the amount of such individual's share depends on the amount of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life, but only if the operating crew of such boat (or each boat from which the individual receives a share in the case of a fishing operation involving more than one boat) is normally made up of fewer than 10 individuals; or".

SEC. 2. The amendments made by this Act shall be effective on January 1, 1978.

95TH CONGRESS
2D SESSION

S. 3125

IN THE SENATE OF THE UNITED STATES

MAY 22 (legislative day, MAY 17), 1978

Mr. DOLE introduced the following bill; which was read twice and referred to Committee on Finance

A BILL

To amend the Internal Revenue Code of 1954 with respect to the treatment of an involuntary conversion of real property to which the special farm valuation provisions of the Federal estate tax apply.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 2032A of the Internal Revenue Code of 1954 (relating to valuation of certain farm, etc., real property) is amended by adding at the end the following new subsection:

"(h) SPECIAL RULES FOR INVOLUNTARY CONVERSIONS OF QUALIFIED REAL PROPERTY.—

"(1) TREATMENT OF CONVERTED PROPERTY.—

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"(A) IN GENERAL.—If there is an involuntary conversion of an interest in qualified real property and the qualified heir makes an election under this subsection—

"(i) no tax shall be imposed by subsection (c) on such conversion if the cost of the qualified replacement property equals or exceeds the amount realized on such conversion, or

"(ii) if clause (i) does not apply, the amount of the tax imposed by subsection (c) on such conversion shall be the amount determined under subparagraph (B).

"(B) AMOUNT OF TAX WHERE THERE IS NOT COMPLETE REINVESTMENT.—The amount determined under this subparagraph with respect to any involuntary conversion is the amount of the tax which (but for this subsection) would have been imposed on such conversion reduced by an amount which—

"(i) bears the same ratio to such tax, as

"(ii) the cost of the qualified replacement property bears to the amount realized on the conversion.

"(2) TREATMENT OF REPLACEMENT PROPERTY.—For purposes of subsection (c)—

"(A) any qualified replacement property shall be treated in the same manner as if it were a portion of the interest in qualified real property which was involuntarily converted,

"(B) any tax imposed by subsection (c) on the involuntary conversion shall be treated as a tax imposed on a partial disposition, and

"(C) paragraph (7) of subsection (c) shall be applied—

"(i) by not taking into account periods after the involuntary conversion and before the acquisition of the qualified replacement property, and

"(ii) by treating material participation with respect to the converted property as material participation with respect to the qualified replacement property.

"(3) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) INVOLUNTARY CONVERSION.—The term 'involuntary conversion' means a compulsory or involuntary conversion within the meaning of section 1033.

"(B) QUALIFIED REPLACEMENT PROPERTY.—The term 'qualified replacement property' means—

"(i) in the case of an involuntary conversion described in section 1033(a)(1), any real property into which the qualified real property is converted, or

"(ii) in the case of an involuntary conversion described in 1033(a)(2), any real property purchased by the qualified heir during the period specified in 1033(a)(2)(B) for purposes of replacing the qualified real property.

Such term only includes property which is to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the qualified real property qualified under subsection (a).

"(4) CERTAIN RULES MADE APPLICABLE.—The rules of the last sentence of section 1033(a)(2)(A) shall apply for purposes of paragraph (2)(B).

"(5) ELECTION.—Any election under this subsection shall be made at such time and in such manner as the Secretary may by regulations prescribe.".

(b) Section 1016 of such Code (relating to adjustments to basis) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) INCREASE IN BASIS IN THE CASE OF CERTAIN INVOLUNTARY CONVERSIONS.—

"(1) IN GENERAL.—If there is a compulsory or involuntary conversion (within the meaning of section 1033) of any property the basis of which is determined under section 1023 and an additional estate tax is imposed on such conversion under section 2032A(c) then the adjusted basis of such property shall be increased by the amount of such tax.

"(2) TIME ADJUSTMENT MADE.—Any adjustment under paragraph (1) shall be deemed to have occurred immediately before the compulsory or involuntary conversion.".

(c) Paragraph (1) of section 2032A(f) of such Code (relating to period of limitations) is amended by inserting "(or if later in the case of an involuntary conversion to which an election under subsection (h) applies, 3 years from the date the Secretary is notified of the replacement of the converted property or of an intention not to replace)" immediately before ", and".

(d) The amendments made by this section shall apply to involuntary conversions after December 31, 1976.

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95TH CONGRESS
2D SESSION

S. 3301

IN THE SENATE OF THE UNITED STATES

JULY 14 (legislative day, MAY 17), 1978

Mr. BAYH (for himself, Mr. CHAFEE, Mr. BROOKE, and Mr. PELL) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Tax Reform Act of 1976.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 212 (a) (3) of the Tax Reform Act of 1976 be amended by removing the period at the end thereof and substituting therefor: ", except for the sale or exchange of a franchise after December 31, 1975, and before March 1, 1977, if the person who is the principal stockholder of the transferee at the time of such sale or exchange was committed to and did, prior to December 31, 1975, purchase more than 50 percent of the voting stock of the transferor.".

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Senator BYRD. The hour of 9:30 having arrived, the committee will come to order. The committee today has before it 15 different tax bills.

The first two bills were introduced by the distinguished Senator from Oklahoma, Mr. Bartlett. Senator Bartlett, if you will come forward, the committee will now consider S. 869 introduced by Senator Bartlett dealing with industrial develoment bond treatment.

Senator Bartlett, welcome, and you may proceed as you wish.

Senator BARTLETT. Thank you, Mr. Chairman. I will read a short version and I will submit a larger, longer version of my remarks for the record.

[The prepared statement of Hon. Dewey Bartlett follows:]

TESTIMONY CONCERNING S. 869, A BILL TO INCREASE THE TAX-EXEMPTION ON SMALL INDUSTRIAL BOND OFFERINGS

Mr. Chairman, I would also like to discuss this morning S. 869, a bill to increase the tax-exemption on small industrial bond offerings from the present 5 million dollars to a proposed 10 million dollars.

I believe that the creation of new jobs by encouraging new industrial construction is a positive step the Congress can take to help keep our economic recovery going and to help fight inflation. It is also a step the Congress can take to help improve the recent trends in capital investment in the United States. These trends in capital investment in the United States have been very discouraging. In fact, the United States ranks 7th of all Western industrial countries in investment for new plants and equipment. If we want jobs for Americans and a reduced inflation rate we must encourage capital investment now in order to modernize our productive base and to insure the increased productivity of our workers. High interest rates are the reason most often given by industrial officials for cancellation of plans for industrial expansion. Tax exemption on interest paid for borrowed obviously provides lower interest rates on industrial borrowings. The one million dollar and $5 million "small issue exemptions" provided for industrial investment bonds in Sec. 103(b)(6) of the Internal Revenue Code of 1954, as amended, were intended to provide just such lower interest rates on industrial borrowings and thereby encourage industrial expansion. However, these exemptions, enacted in 1968, are no longer adequate given the continued high inflation rates in our Nation's economy.

Let me use Oklahoma as an example of how effective these exemptions on small issue industrial development bonds have been in the past and why an increase in the dollar limit for the exemption along with removal of the limitation with respect to "capital expenditures" made at facilities financed wih such bonds is needed for the future.

During the past decade Oklahoma has been highly successful in creating new jobs throughout the state. During this period more than $2 billion have been invested in new and expanded manufacturing facilities. In the past 6 years alone more than 48,000 new manufacturing jobs have been created.

This growth has enabled Oklahoma to develop a more diversified economy, one that is not totally dependent on oil and agriculture. One of the major factors in the growth and development of manufacturing in Oklahoma, particularly in the rural areas, has been the availability of industrial revenue bonds. The availability of this important financing vehicle was responsible for many of the plants which have located across my State.

It is most important that you are aware of the economic benefits which have come to my State as a result of just a few of the projects that were financed by this method. The Oklahoma Department of Industrial Development authorized a special study of a select group of 27 projects financed with tax exempt industrial revenue bonds to measure the economic impact of these projects on Oklahoma. This study was made in cooperation wtih the Center for Economic and Management Research at the College of Business Administration at the University of Oklahoma.

These 27 projects were built at a total cost of $58,254,000 and provided jobs directly for 5,979 people. The creation of these new jobs resulted in the creation of 10,389 additional jobs in other sectors of the Oklahoma economy. These new plants each year provide direct personal income of $69,660,680 and generate a total of $56,470,000 in taxes each year. Of this amount, $10,115,000 goes to the state, $1,615,000 to local units of government and $44,740,000 in Federal taxes are generated each year.

During the past 9 years, over 500 new manufacturing facilities have been constructed throughout Oklahoma. It is estimated that industrial revenue bonds were utilized in financing more than half of these new manufacuring facilities. Industrial revenue bonds are issued by a State, county, or municipality through industrial trust authorities at no cost to the taxpayers. The bonds are retired solely from lease rental payments made by the manufacturer occuping the building. These bonds are exempt from federal income tax and as a result, bring a rate of interest lower than conventional financing. These reduced financing costs make possible many industrial projects which would not otherwise be feasible.

As I already mentioned, there is a $5 million limitation by the Federal Government on the amount of industrial revenue bonds which can be issued on any one project and still remain tax-exempt. However, due to rising construction costs which have more than doubled since 1968, the $5 million limitation is no longer considered realistic. Several of the projects financed in Oklahoma approached the $5 million figure and at today's costs these projects would exceed the limit. For example, in Guymon, a Swift and Co. facility was financed through industrial revenue bonds at a cost approaching $5 million. It is estimated that the cost for constructing a similar plant of this nature at today's costs would be over $8,500,000. A special provision of the Internal Revenue Code states that the $5 million limitation must include all capital expenditures for a 6 year period, beginning 3 years before and ending 3 years after the issuance of the bonds.

Several other industrial projects in Oklahoma have approached the $5 million limitation. What follows is a sampling of some of these facilities, showing their size and indicating their benefit to our economy:

Eltra Corp. built a facility at a cost of $4,300,000 in Wagoner to produce electric motors. This new plant has provided jobs for 300 people and has increased personal income by $3,139,000 annually.

The U.S. Electric Motors Division of Emerson Electric invested $4,250,000 in Durant and provides employment for 190 people and generates additional personal income of $3,102,000.

In early 1972, Blackwell Zinc in Blackwell. Okla. announced it was closing its outdated and obsolete zinc smelting facility where 800 persons were employed. It was quite a staggering blow for this northern Oklahoma community. Utilizing industrial revenue bonds, the community has been successful in attracting 4 new industries to their new industrial part just west of the old zinc facility.

Electron has been the largest with a $4,800,000 castings facility which will eventually employ 400 people.

Raleigh Bicycle in Enid invested $4,300,000 in a new bicycle factory, the first ever built by the company in the United States and employed 300 people. Unfortunately, the market for their bicycles declined and they have since ceased their operation but their facility and bond payments have been taken over by another company.

Mid America Yarn Mill in Pryor was built at a cost of $3,800,000 and provides employment for approximately 150 people, generating personal income of $1,971,000 annually.

There are many other manufacturing facilities all over Oklahoma which have made use of the industrial revenue bond procedure.

Lockheed invested $3 million in a major facility at McAlester which employs 100 people in the manufacture of airplane parts. This was one of the earliest facilities financed by the industrial revenue bond method in Oklahoma.

Komar and Sons, which employs 600 people in McAlester was also financed with industrial revenue bonds.

Cinch Manufacturing, a division of TRW, is in operation at Vinita and makes electronic components, employing 650 people. The company started operations 5 years ago with a work force of 50 and has expanded several times using industrial revenue bonds.

Colt Industries produces emission control equipment at its Sallisaw facility and employs 300 people. The building was built by the Sallisaw Industrial Authority initially for another company through a revenue bond issue. The availability of the building was a key factor in Colt's decision to locate in Sallisaw.

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Red Devil, one of the Nation's leading manufacturers of home hardware equipment, occupies a facility in the Mid America Industrial District at Pryor and employs 225 people.

Adams Hardfacing is recognized as one of the Nation's leading manufacturers of farm equipment and employs 125 people in Guymon. Adams has undergone 4 major expansions in the recent past.

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Worthington Pump started operating at Shawnee in 1973 and has already expanded the size of its facility. The company now employs 125 people in the manufacture of pumps.

Westran of Duncan is one of the most recent projects in Oklahoma utilizing industrial revenue bonds. The company, which is investing $3 million in the project, will employ 115 people in the manufacture of steel castings.

(NB: the above employment figures are as of the middle of 1977)

As I said previously, the above examples are merely a sampling of the extent to which the industrial development bonds have been used in Oklahoma. I think they graphically demonstrate that this mechanism is very useful and that those who claim it is inefficient have not studied the record thoroughly. I also believe that the samples indicate that the $5 million limitation has become inadequate. Oklahoma is only 1 of 40 States throughout the Nation which have the capabilities of issuing industrial revenue bonds for new and expanded manufacturing facilities. All of these States portray the same success story of new industry moving into those areas which have the initiative and aggressiveness to utilize this method of financing.

The need to provide productive employment opportunities in all areas of the country is greater now than it was in 1968 when the $5 million limit was set. The problem of unemployment and inflation has been compounded by the cutback in industry's plans for capital expansion which have resulted in great part because of increased interest rates. For this reason, the tax exempt industrial development bond concept is more valid and necessary than ever before.

In 1975 the Oklahoma legislature passed a joint Senate-House resolution proclaiming their support for new Federal legislation to increase the $5 million limitation to a clear $10 million. To keep new industry coming into Oklahoma and to encourage the creation of new industry throughout the nation which otherwise would not be considered feasible because of the high interest rates, Oklahomans feel that it is important that the dollar limitation for industrial revenue bonds be increased.

Mr. Chairman, your support is needed in helping to keep Oklahomans and Americans at productive work and to insure that the United States remains a growing, dynamic Nation.

STATEMENT OF HON. DEWEY BARTLETT, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator BARTLETT. Mr. Chairman, I urge for your consideration the provisions of Senate bill 869, a bill to increase the tax exemption of small issue industrial bonds from the present $5 million to a proposed $10 million. I understand that the administration has a proposal which would limit the use of these tax-exempt industrial revenue bonds to economically distressed areas such as defined in the National Development Bank Act of 1978. I do not believe such a measure is in the best interests of either my State of Oklahoma or of the Nation, and would urge the substitution of my proposals for those of the administration.

Under section 103(B) (6) of the Internal Revenue Code, interest on industrial development bonds is tax exempt if the bonds are part of an issue which is limited to $1 million per user in a given county or municipality, or at the election of the issuer of the bonds, to $5 million per corporate user in a given county or municipality.

If the $5 million election is exercised, however, the capital expenditures incurred by the user of the facilities financed by such bonds in that county or municipality, including both those expenditures financed by the issuance of the bonds and those expenditures made with funds raised from other sources—may not exceed a total of $5 million during the 6-year period beginning 3 years prior to the date of the bond's issuance and ending 3 years after their issuance. Violation of this limit makes interest on the bonds taxable retroactively.

These exemptions were enacted in 1968 and are no longer realistic, given the changes in our Nation's economy since then. Inflation has made the dollar limitations woefully inadequate. Construction costs, for example, have more than doubled since 1968 and the $5 million limitation is no longer realistic. Moreover, the 3 years forward and 3 years back capital expenditure rule relating to the $5 million exemption has proven to be inequitable and self-defeating.

My proposal is quite simple. It would amend section 103(B) (6) so as to increase the dollar limit for the small issue exemption for such tax free bonds from $5 million to a clear $10 million and would remove the limitation with respect to capital expenditures made at the facilities financed with such bonds.

In today's environment of high inflation, high interest rates and depressed capital investment by industry, I believe that such an increase in the dollar limit for these industrial development bonds would go a long way toward correcting these national problems.

In order to emphasize how important these tax exempt industrial revenue bonds can be to the prosperity of the Nation, I would like to cite a few figures from a study of just 27 projects financed by these bonds in Oklahoma.

The Oklahoma Department of Industrial Development reported that these 27 projects were built at a total cost of $58,254,000 and provided jobs directly for 5,979 people. The creation of these new jobs resulted in the generation of 10,389 additional jobs in other sectors of the Oklahoma economy. These new plans each year provide direct personal income of $69,660,680 and generate a total of $56,470,000 in taxes each year. Of this amount, $10,115,000 goes to the State;

$1,615,000 to local units of government; and $44,740,000 in Federal taxes are generated each year.

The above figures are for just 27 projects, and it has been estimated that in the past 9 years, over 250 manufacturing facilities have used industrial revenue bonds for financing in Oklahoma alone.

Mr. Chairman, I do not believe that this incentive for industrial development should be restricted to economically distressed areas as would be the case under the President's proposal, and I urge the adoption of my proposal for a clear $10 million exemption.

My complete statement contains more information on the benefits of these tax-exempt bonds and the need for increasing the dollar limitation of them. I would like to submit that statement for the record, as well as a statement by Mr. Paul B. Strasbaugh, executive vice president of the Oklahoma City Chamber of Commerce.

Senator BYRD. Thank you, Senator Bartlett. Both statements will be published in full in the record.

[The prepared statements of Senator Bartlett and Mr. Strasbaugh follow:]

STATEMENT OF SENATOR DEWEY BARTLETT ON S. 869

Mr. Chairman, I would also like to discuss this morning S. 869, a bill to increase the tax-exemption on small industrial bond offerings from the present 5 million dollars to a proposed 10 million dollars.

I believe that the creation of new jobs by encouraging new industrial construction is a positive step the Congress can take to help keep our economic recovery going and to help fight inflation. It is also a step the Congress can take to help improve recent trends in capital investment in the United States. These trends in capital investment in the United States have been very discouraging. In fact, the United States ranks 7th of all western industrial countries in investment for new plants and equipment. If we want jobs for Americans and a reduced inflation rate we must encourage capital investment now in order to modernize our productive base and to insure the increased productivity of our workers. High interest rates are the reason most often given by industrial officials for cancellation of plans for industrial expansion. Tax exemption on interest paid for borrowed obviously provides lower interest rates on industrial borrowings. The one million dollar and 5 million dollar "small issue exemptions" provided for industrial investment bonds in Sec. 103(b)(6) of the Internal Revenue Code of 1954, as amended, were intended to provide just such lower interest rates on industrial borrowings and thereby encourage industrial expansion. However, these exemptions, enacted in 1968, are no longer adequate given the continued high inflation rates in our nation's economy.

Let me use Oklahoma as an example of how effective these exemptions on small issue industrial development bonds have been in the past and why an increase in the dollar limit for the exemption along with removal of the limitation with respect to "capital expenditures" made at facilities financed with such bonds is needed for the future.

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This growth has enabled Oklahoma to develop a more diversified economy, one that is not totally dependent on oil and agriculture. One of the major factors in the growth and development of manufacturing in Oklahoma, particularly in the rural areas, has been the availability of industrial revenue bonds. The availability of this important financing vehicle was responsible for many of the plants which have located across my state.

It is most important that you are aware of the economic benefits which have come to my state as a result of just a few of the projects that were financed by this method. The Oklahoma Department of Industrial Development authorized a special study of a select group of 27 projects financed with tax exempt industrial revenue bonds to measure the economic impact of these projects on Oklahoma.

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The need to provide productive employment opportunities in all areas of the country is greater now than it was in 1968 when the 5 million dollar limit was set. The problem of unemployment and inflation has been compounded by the cutback in industry's plans for capital expansion which have resulted in great part because of increased interest rates. For this reason, the tax exempt industrial development bond concept is more valid and necessary than ever before.

In 1975 the Oklahoma legislature passed a joint Senate-House resolution proclaiming their support for new federal legislation to increase the 5 million dollar limitation to a clear 10 million dollars. To keep new industry coming into Oklahoma and to encourage the creation of new industry throughout the nation which otherwise would not be considered feasible because of the high interest rates, Oklahomans feel that it is important that the dollar limitation for industrial revenue bonds be increased.

Mr. Chairman, your support is needed in helping to keep Oklahomans and Americans at productive work and to insure that the United States remains a growing, dynamic nation.

OKLAHOMA CITY CHAMBER OF COMMERCE STATEMENT COVERING ADMINISTRATION'S TAX PROPOSALS

The membership of our Chamber of Commerce is approximately 5,000. Our principal objective is the creation of job opportunity through economic and industrial development programs. We have a broad comprehensive range of activity that covers all aspects of community development. Until 1970, Oklahoma had been an out-migration State. Working with our contemporaries throughout the State that trend has now been reversed and, as a result, the growth of the Oklahoma City Area and the entire State is significant. The unemployment level in Oklahoma is below the national average. In Oklahoma City, over the last 12 months, the unemployment level has been reduced by 2 percentage points.

Our programs and the programs throughout the State are geared to the expansion of existing industry and the settlement of new industry. The latter of which is primarily for the purpose of serving growing markets in the South and Southwest and not relocation from older industrial areas. While any economic development program depends on many factors, the industrial revenue bond methodology has been the cornerstone of Oklahoma's program. Through this activity we have been able to develop a wide range of municipal, industrial, educational, cultural and health care facilities.

We are concerned that the Administration's proposition will no longer allow pollution control equipment to be financed through the industrial revenue bond methodology. We are becoming increasingly concerned, since over 2 percent of the nation's gross national product is now expended for pollution controls. For many companies, the added interest cost to be incurred for pollution control improvements will be substantial and, in some cases, may be prohibitive.

Secondly, while we applaud the President's proposal to raise the ceiling for small issue industrial revenue bond issues from five million dollars to ten, we express major concern over the fact that the President's proposal calls for an elimination of the device in all areas except economically depressed areas. In areas where economic growth has been substantial and where unemployment levels have been reduced, the increase in the ceiling on small issue bonds will be totally defeated, because they will be unable to qualify under the terms of "economically depressed." This proposal will, in our opinion, create an unfair condition across the nation and tend to pit one area against the other. There is enough regional jealously in America today without contributing to more. The several States and sub-divisions therein should be free to compete for economic growth without "Federal Area Designated" barriers. Most states now have the mechanism of industrial revenue bonds and they are using it effectively in developing jobs.

Revenue Bond financing has been the principal factor in the major economic growth in the State of Oklahoma. The public authority in Oklahoma City has been responsible for creating, in the past ten years, more than 45,000 new jobs in the metropolitan Oklahoma City area. Most of those jobs created initially by industrial revenue bond financing would not have been created, nor would many of the jobs created by subsequent expansion have been possible, had not the facility financing been available to industry at favorable interest rates through industrial revenue bond financing.

In the worldwide market place, the United States needs all the advantages and strength it can muster. The soundness of our economic growth and development must be preserved and strengthened. We need jobs! The application of Industrial Revenue Bond financing is vital to this effort.

Senator BARTLETT. Mr. Chairman, I have a statement on Senate bill 2825.

The Chairman. Yes, you may proceed.

[The prepared statement of Hon. Dewey Bartlett follows:]

STATEMENT BY SENATOR DEWEY F. BARTLETT ON S. 2825

Mr. Chairman: I would like to thank you and the members of the Finance Committee for allowing me to appear today to testify on my legislation, S. 2825.

This bill adds a small number of organizations to the list of those exempted from the private foundation rules by section 170(b)(1)(A)(iii) of the Internal Revenue Code. Under this section, organizations are exempted if they are operated and maintained for the principal function of providing long-term care, comfort, maintenance, or education to indigent widows, children, elderly persons, or the totally disabled.

The present private foundation rules were enacted in 1969 to curb situations such as that in which a large contributor established a foundation which would be responsive only to his own desires, rather than the public interest. This principal does not apply to long-term care facilities, where all noninvestment assets are used in carrying on the charitable functions for which the facility is exempt. Most of these long-term care facilities were founded prior to the present private foundation provisions, and some of the existing institutions were established prior to the passage of the constitutional amendment providing income tax.

The Sand Springs Home in Sand Springs, Okla. is an example of a foundation adversely affected by the 1969 change. It was founded in 1908 by Charles Page, a pioneer Oklahoma oilman, and incorporated in 1912, with a primary function of operating as an orphanage. In 1914, a separate widow's colony was established for the care of widows and their children.

During its years of operation, the home has cared for hundreds of orphans and thousands of widows and their children. Not one penny of Government aid (Federal, State, or local) has been used to carry out its operations. The home is fully funded from the income of its investments.

Since 1925, the home has operated under the auspices of the Free and Accepted Masons of the State of Oklahoma. The Grand Master of the Oklahoma masons is empowered to appoint the members of the Board of Trustees of the home.

The home serves a definite and accepted public function in the State of Oklahoma. Children are committed to the home by order of the district courts of the State of Oklahoma, which charge the home with the duty of care, maintenance, and the education of the children.

Widows and their children are admitted to the widows colony on application to the home, and the children of the widows remain under the jurisdiction of their mothers. These widows would otherwise be compelled to seek State and Federal assistance.

Personal assets of children committed to the home are held in trust under the guardianship established by the probate division of the Tulsa County District Court. Individual bonded guardians are appointed by the court, and all personal assets are there impounded. All such assets, along with any interest accruing to them while the child is at the home, are paid over to the child upon reaching his or her majority.

The home's assets consist of a widely diversified group of holdings. They include the land and buildings directly utilized for carrying out its exempt activities. The home also owns tracts of vacant land which are appreciating in value, stock in several small wholly owned companies such as the Sand Springs Railroad Company, oil property, certificates of deposit, and investments in government obligations.

The two private foundation provisions which have the greatest effect on institutions such as the home are Sections 4940 and 4942. Section 4940, of course, requires the payment of a 4 percent excise tax on all of the investment income or a private foundation. This is the provision hopefully to be modified by H.R. 112 which was reported by this committee on May 9, 1978. Last year the home paid $40,898 under Section 4940. These funds were obviously diverted from charitable functions.

Section 4942 of the Internal Revenue Code requires private foundations to distribute a fixed percentage of their assets each year in carrying on their exempt functions. This section disregards income from other assets. For many long-term care facilities this requires a larger than necessary continuing payment each year.

Sand Springs Home is experiencing severe problems with respect to the minimum distribution requirements of section 4942. While this section may not be a great problem to grantmaking organizations which simply adjust their grant payments to meet the distribution requirements, organizations such as the home, which must meet obligations of long-term care and which have already invested considerable sums and assets used to carry out their charitable purposes, are experiencing problems with the requirements of section 4942.

Long-term care facilities must be in a position to hold assets which will appreciate in value to insure that they will be able to meet their continuing responsibilities and future capital needs. This is particularly important in light of inflation. Institutions such as the Sand Springs Home must be in a position to invest for the future as well as for current income. They should not be forced to engage in wasteful, needless spending to meet artificial requirements of tax laws. This artificial spending is likely to affect future financial stability of this home as well as others.

S. 2825 solves this problem. It provides that long-term care facilities, formed before October 31, 1969, will not be classified as private foundations. Instead, they will be treated in the same fashion as universities, schools, medical research facilities, and hospitals. All of these organizations are considered public charities (not private foundations) because of the type of activity they carry out. This consideration is provided for these institutions regardless of the source and amount of their income. The fact that the Sand Springs Home's endowment has come from one individual should not prevent it from being classified as a public charity, just as it does not prelude a school from this designation.

In addition to the Sand Springs Home, this bill will help many other worthy organizations throughout the country.

Mr. Chairman, I would like to attach at this point, for inclusion in the record, a partial list of such institutions.

Mr. Chairman, I would again like to express my appreciation to you and the committee for taking time to consider S. 2825. Although a minor piece of legislation, I believe that its basis is certainly one that the Congress is interested in fostering.

Attachment.

CHARITIES OPERATED BY FRATERNAL ORGANIZATIONS

NAME AND ADDRESS OF ORGANIZATION, DATE FOUNDED

Hendrick Home for Children, Abilene, Tex., 1939.
Home for Homeless Women, Wilkes-Barre, Pa., 1893.
Judson Palmer Home. Findlay, Ohio, 1950.
Myron Stratton Home, Colorado Springs, Colo., 1909.
Aged Woman's Home of Georgetown, Washington, D.C., 1860.
Heritage, San Francisco, Cal., 1850.
Warner Home, Jamestown, N.Y., 1911.
Elizabeth Shoemaker Home, Washington, D.C., 1952.
Smith Memorial Home, New London, Conn., 1881.
Guyor Memorial Home, Peoria, Ill., 1889.
Sand Springs Home, Sand Springs, Okla., 1908.
Miriam Osborn Home, Rye, N.Y., 1908.
James Sutton Home, Wilkes-Barre, Pa., 1920.
Amasa Stone House, Cleveland, Ohio, 1877.
Widow's and Old Men's Home, Cincinnati, Ohio, 1948.
Lisner Home, Washington, D.C., 1941.
Society for the Relief of Destitute Orphan Boys, New Orleans, La., 1820.
State Street Children's Home, New Orleans, La., 1866.
Moor Children's Home, El Paso, Tex., 1959.
Andrew Freedman Home, Bronx, N.Y., 1924.
Rogerson House, Boston, Mass., 1860.
Marcus L. Ward Home, Maplewood, N.J., 1921.
Cartwell Home, Palestine, Tex., 1953.
Wiles Home, Brockton, Mass., 1893.
St. Luke's Episcopal Church Home, Highland Park, Mich., 1861.

Senator BARTLETT. I appreciate the opportunity for appearing on both of these bills.

This bill adds to the list of organizations exempt from private foundation rules. These rules already exclude most institutions operated and maintained for the principal function of providing long-term care, comfort, maintenance, or education to indigent widows, elderly persons, children and the permanently and totally disabled. Long-term care facilities do not exhibit the same problems which Congress tried to correct in 1969. They are not established by a large contributor who is seeking to only protect personal desires with total disregard for public interest.

The Sand Springs Home in Sand Springs, Okla., is an excellent example of one of the few long-term care facilities not currently exempted. It was founded in 1908 by Mr. Charles Page a pioneer Oklahoma oilman, and incorporated in 1912 with the primary function of operating as an orphanage. The home later expanded into a widows colony, and in 1925, came under the auspices of the Free and Accepted Masons of the State of Oklahoma. It has since provided assistance to hundreds of orphans and thousands of widows without Federal, State, or local assistance.

Mr. Page was an extremely wise and farsighted individual. He provided the home assets which would insure the home's operations almost indefinitely. The home's present assets consist of it own physical facilities and adjacent lands, as well as vacant tracts which are appreciating in value, stock in several small wholly owned companies, oil property, certificates of deposit and investments in government obligations.

The two Internal Revenue Code provisions which have the greatest impact on the home are sections 4940 and 4942. It appears that through H.R. 112, the problems with section 4940 will be corrected—that is reducing the 4 percent to 2 percent—but section 4942 continues to plague the operation of this home and many others.

As you are aware, Mr. Chairman, section 4942 requires private foundations to distribute a fixed percentage of their assets in each year that they are carrying out exempt functions. This requirement completely disregards income from other assets.

Grantmaking organizations have no problem with this section in that they may adjust the amount of their grants from year to year. Institutions such as the home must be mindful of their long-term obligations. Therefore, tax requirements which cause them to engage in wasteful and needless spending affect their future financial stability and would eventually result in the demise of the home.

Senate bill 2825 solves this problem. It provides long-term care facilities, formed before October 31, 1969, will not be classified as private foundations. Instead, they will be treated in the same fashion as universities, schools, medical research facilities, and hospitals. These organizations are considered public charities, not private foundations based on the type of activities they carry out. This designation has been provided disregarding the source and the amount of their income.

Operations such as the Sand Springs Home should be classified in a similar category. The fact that this home or any other of a similar nature is endowed by one individual should not prevent it from being classified as a public charity.

Mr. Chairman, I again thank you and the committee for considering my legislation during this hearing.

Senator BYRD. Thank you, Senator Bartlett. May I ask this? I notice that this legislation is cosponsored by the Senator from Texas and the Senator from New York, as well as Senator Bellmon of Oklahcma.

Senator BARTLETT. That is correct.

Senator BYRD. Is this quite widespread in its application, do you know?

Senator BARTLETT. Mr. Chairman, there are about 30 such facilities scattered through the United States, and so it affects a number of other States besides Oklahoma.

Senator BYRD. Thank you.

At this point I ask Mr. Samuels, the Deputy Tax Legislative Counsel for the Department of Treasury, if he has a comment and what is the Treasury's position on each of these bills.

Mr. SAMUELS. Thank you very much, Senator Byrd.

The Treasury is opposed to S. 869 which would increase the small issue exemption from $1 to $10 million for a number of reasons, but principally because it would result in some of the largest industrial corporations competing with State and local governments in marketing tax-exempt bonds. This would drive up interest rates for conventional municipal finance, borrowings to finance schools and city halls would be at a much higher interest rate.

It would also entail a substantial revenue loss to the Treasury.

Senator BYRD. What do you estimate the revenue loss to be?

Mr. SAMUELS. Well, our revenue estimators, Senator, have not had an opportunity to estimate the revenue on these bills because of the short time they have had to study them, and this has been a busy week for them. But they think that it would be substantial.

We would like to request that the record be held open so that we could submit a full written statement with revenue estimates on each of these bills.[1]

Senator BYRD. The committee will hold the record open. I assume you will get whatever additional information you want into the committee in a reasonable length of time.

Mr. SAMUELS. With respect to the administration's proposal to target the exemption for industrial development bonds to distressed areas, the administration has suggested increasing to $20 million—increasing from $5 million to $20 million the amount of the capital expenditures that can be made by private industrial corporations, but targeting that to distressed areas so there would be no increased revenue loss.

The revenue gain from limiting it to distressed areas would be offset by the revenue loss—or the revenue loss of increasing it to $20 million—would be offset from the revenue gain by limiting it to distressed areas.

Senator BYRD. Well, who would determine what is a distressed area?

Mr. SAMUELS. Well, the Secretary and the Congress obviously would determine that. We have suggested and set forth a list of what the Treasury Department would treat as distressed areas in the President's urban program.

I think our principal concern with this bill is that it would result in, as I said, the largest private industrial corporations competing directly in the tax-exempt market with local, State and government financings, which would drive up interest costs and, hence, property taxes for conventional municipal debt.

Private corporations have access to other funds. State and municipal governments do not.

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[1] At presstime Feb. 14, 1979 the information requested of the Treasury Department had not been received by the committee.

Now, I also note that this bill increases the $1 million exemption to $10 million, not the $5 million, so it appears that under this bill that a part of a factory—if the whole factory was going to cost more than $10 million—say it was a $100 million automobile plant, $10 million of it could be financed with tax exempt debt, so every company will have one shot at this every time they build a factory.

The justification for this kind of financing, which was once to help rural areas attract factories, no longer is supportable because every State or municipality now has legislation authorizing issuance of industrial development bonds, so no one area has an advantage over any other.

Senator BYRD. What is the limit now on tax exempt?

Mr. SAMUELS. $1 million is the general limit on industrial development bonds. However, that—you can elect, a company or a municipality can elect to increase that to $5 million, but under the $5 million exemption, you have to count all capital expenditures made in the county within a 6-year period.

So you really cannot build part of a $10 million plant with $5 million of tax exempt debt.

Senator BYRD. What about the second bill that Senator Bartlett introduced?

Mr. SAMUELS. The second bill we also oppose———

Senator CURTIS. May I ask some questions about that first one?

Senator BYRD. Yes, indeed.

Senator CURTIS. Has the Treasury ever made any actual check about the effect on the revenue? We have been hearing this same Treasury argument for years.

Now, I could take you to a community where industrial development bonds have built a meatpacking plant. It has been successful. It is local capital. It has been paying corporate taxes. They provide jobs for 60 people and the jobs did not exist before. Those individuals are well paid. They are paying income tax, they are paying payroll taxes.

We have a good strict State law in reference to the issuance of these bonds and we turned down some fly-by-night people who wanted to use them because the State requires rigid supervision so that the bonds are paid off.

Now, without a doubt, that particular plant would not have been built without these industrial development bonds. There is no doubt the Treasury would not have gotten any revenue, and whenever tax exempt bonds are issued where there will be no bonds issued, no building undertaken, there is no loss.

Also, I would like to point out that the Treasury is totally unmindful of inflation. If $1 million and $5 million were adequate levels before, and they were not, it should be substantially raised now, because it costs a great deal more today to modernize or to build a plant.

Now, have you ever gone into any particular community and made a check as to what happened to the revenue when a community avails itself of this type of financing?

Mr. SAMUELS. We have not checked the revenue loss with respect to a particular community or whether the plant would have been built in that community, Senator, but we do not think that this exemption results in the building of a plant where one would not have been built.

Earlier when industrial development bonds were being issued when only some areas had enabling legislation, industrial development bonds did encourage manufacturers to build their plant in a particular area. Soon, however, all States, all 48 States, had legislation authorizing industrial development bonds.

Senator CURTIS. Well, now you are talking about the problem of moving a plant from one State to another. It is true that is on the decline because of new opportunities, but that does not carry through to establish the validity of your statement that——

Mr. SAMUELS. Well, we have never——

Senator CURTIS [continuing]. Industrial development bonds are not being used to develop job opportunities that did not exist before.

Mr. SAMUELS. We think that they do reduce the cost of building a plant and therefore to the extent they reduce the cost of building a plant they might encourage a plant to be built. However, we think there are more equitable and efficient ways to reduce the cost of capital and the President has recommended a substantial reduction in the investment credit, or liberalization of the credit, and a substantial reduction in corporate tax rates, and that does not result in competition with municipal borrowing, either of those.

Senator CURTIS. I might buy your argument if the U.S. Government was not making loans, through the Small Business Administration, for industrial development and other types of loans, all of which takes money out of the Federal Treasury.

Also, we have a great many jobs programs that are going on that take money out of the Treasury. Now, this is a system whereby the financing does not come from the Treasury, not even a Federal guarantee, but it uses local credit to bring these results.

And the same arguments you now cite were advanced by the Treasury all through the years even though at the time one of the Senators from Mississippi informed me that a great many of their bond issues were for modest amounts of less than $1 million and that it was a tremendous help in providing jobs for blacks.

And yet the Treasury has consistently opposed this.

The effectiveness of the statute is in a jam right now because Treasury at one time asserted the authority to throw industrial development bonds out. And that is when Congress had to come in and we struggled with a $1 million limitation for some time, and then we got this conditional one up to $5 million.

Your suggestion that, in distressed communities, it can go to $20 million is not satisfactory, because that requires an adjudication of what is a distressed area. It also ignores the fact that we ought to be ahead of the game and create some jobs before an area becomes distressed.

So I wish you would update your statement. Go out and look over one of these places and find out if it is not true that you gain in revenue.

Mr. SAMUELS. The administration is interested in increasing capital investment and increasing jobs, but we do not believe tax exemption, or debt to finance them, is the most efficient or effective way to create that investment or those jobs, and I would like to point out that here is a substantial revenue expenditures, just as certainly if there had been a direct budget outlay when you allow interest on debt to go untaxed. I mean——

Senator CURTIS. But you have made no calculation of how much increased revenue you have had.

Mr. SAMUELS. We will do that with respect to this particular bill and submit it for the record, Senator. We have had really less than a week to work up the revenue estimates on these bills and our revenue estimators have been busy on other matters as well.

Senator CURTIS. I will not take any more of the time of the committee because I am fully aware that you, alone, do not arrive at this policy in the Treasury Department. But their argument is old hat. I have been hearing it for 15 years. It does not hold water. I could buy the argument if we had absolute private financing in every respect, across the board. That is not the case. We are pouring out money from the Treasury for more programs than I can count. It becomes unnecessary when you use this vehicle.

Mr. SAMUELS. I just might note that the Municipal Finance Officers of America and other associations representing State and local governments are on record as opposing industrial development bond financing because it does mean higher interest rates for their borrowings to build municipal facilities. With those high interest rates, the only way they can pay them, or the principal way they can pay them, is higher property taxes and I am sure we are all interested in keeping property taxes down.

Senator BYRD. Well, I have some doubt that I can support Senator Bartlett's proposal as a mater of policy. So, in that sense, I agree with the Treasury. But the Treasury is advocating something similar to it. As I understand it, you have a proposal before the Congress which would increase the tax exempt limits on industrial development bonds. Is that not correct?

Mr. SAMUELS. That is correct, Senator, but that is only if the proceeds of the bonds are used in a distressed area.

Senator BYRD. That gives you very wide political latitude, too.

Mr. SAMUELS. It is not intended to do that.

Senator BYRD. Well, I do not think I can support your proposal either. I think you argued pretty persuasively against Senator Bartlett, but now you are turning around and arguing the other side of it.

Mr. SAMUELS. Well, there is no increased revenue loss in the case of——

Senator BYRD. There never is when Treasury advocates something. Now what about the next proposal, S. 2825.

Mr. SAMUELS. The Treasury also opposes S. 2825. We believe that providing the same tax treatment for long-term care organizations as for colleges, churches, and other organizations listed in section 170 of the code defining public charities, is not justified. We think these long-term care facilites are less likely to have a broad base of public support, like a college or a church, and therefore we think it is inappropriate to treat them as public charities.

Senator BYRD. Why are they different?

Mr. SAMUELS. Well, I think that you would have to go back to the definition of private foundations and what they were being used for. Principally, I think by wealthy families to keep control of the family business without paying the estate tax on the value of the property. The property would be left by the family to this private foundation and the family members would be on the board of the foundation.

There would be a large charitable deduction to the estate, so there would be no tax on that wealth, and yet the family would still be in control of their business through their representation on the board of the foundation. They would still retain some stock in the company, but what we found is large pools of individual wealth going untaxed from generation to generation while the benefits of that wealth continued to be enjoyed by the family, or the individual and his family members.

The Congress, in—and there are also dealings between this company held by the private foundation and the board members or the stockholders and their families—and the Congress, in 1969, decided that they ought to put an end to that practice, and defined private foundations in a way that made it clear that they would be distinguishable from public charities.

One of the distinctions is a broad base of public support which we think you are unlikely to find in the case of a long-term health-care organization.

Senator BYRD. Thank you.

Senator Curtis?

Senator CURTIS. I would first like to hear what Senator Bartlett has to say. I do not think that what the Treasury has said has much to do with what he wants to do here.

Senator BARTLETT. Well, I certainly cannot understand the Treasury on this at all. This provides, in the case of the latter bill, 2825, that it would be restricted for the long-term care comfort, maintenance or education of indigent widows, elderly persons, children and the permanently and totally disabled.

Now, in the case of the Sand Springs Home, they have never received one cent of local, State, or Federal taxes or moneys. This is operated completely by the private funds, by the revenues generated from the various assets that the Sand Springs Home had.

Senator CURTIS. The Sand Springs Home is not part of a private family foundation, is it?

Senator BARTLETT. No, it is dedicated entirely for the operation of this home for widows and for children. And it would be undoubtedly—the assets undoubtedly would be dwindled away by the reduction yearly of a certain percentage for investments.

Senator CURTIS. Now, does this bill relate to this particular facility, or does it deal with all of them?

Senator BARTLETT. It deals with all like facilities, and I understand there are some 30 scattered around. There is one in Texas, there is one in New York.

Senator CURTIS. In other words, they operate totally as a charitable enterprise, without profit to anyone. Is that correct?

Senator BARTLETT. That is correct.

Senator CURTIS. And without any individual gaining from the appreciation of the assets?

Senator BARTLETT. That is correct.

Senator CURTIS. And yet, under existing statutes, they cannot qualify for tax exempt status as most of the institutions rendering a similar type of service are able to do. Is that right?

Senator BARTLETT. Yes, that is correct.

Senator CURTIS. Why are they excluded from tax exempt status now. Can you tell us?

Senator BARTLETT. There was a change made in the law in 1969—and, of course, I do not think this is in the best interests of the various States involved, and I think the substitution of this proposal would relieve ultimately the obligation to the Federal Government probably to take over these operations.

So I think it is a very shortsighted action on the part of Treasury. I cannot see their purpose. I think they would like it for private foundations to handle the various responsibilities of charity throughout the county.

Senator CURTIS. What you are faced with is that the Treasury regulation is defining the institutions to be tax exempt exclude these?

Senator BARTLETT. Right.

Senator CURTIS. That is all I have.

Senator BARTLETT. Mr. Chairman, if I may also comment on the other one, a very rough figuring shows that the tax exempts cost per job, in Oklahoma at least, is about $10,000 per job compared to about $30,000 for a CETA job. Incidentally, in Oklahoma recently one CETA job was offered as a door prize at a community action meeting to increase the attendance.

But there is another big difference—and I would like the chairman to take notice of this—that one of the big problems that this country has, as he well knows, is a very low ranking among the industrial nations of the free world in new plants and equipment, and this is a great incentive for new plants and equipment in these jobs.

The experience in Oklahoma has been that most of the plants have been built in the rural areas. Oklahoma is one State that has had a problem of migration from the rural areas to the city areas, or to another State, and this has done an awful lot toward stopping that migration and providing job opportunities in the less-populated areas of the State.

So I think it has been etxremely effective. The inflation rate today is certainly more than twice that of 1968—more than that—and so I think there is obviously a great need to update this more to the present time to take care of that change.

I think the Eastern States, which have tended to oppose this kind of legislation in the past, have an opportunity with it to retain industry that might otherwise move out, because they have a chance to build a new plant and have new equipment and update the facilities to make it more attractive for their employees. So I think it is very important legislation, and it is a very reasonable cost to the Federal Government for an increase in the capability of this country to manufacture goods and services.

Senator BYRD. Senator Hansen?

Senator HANSEN. I have no questions.

Senator BYRD. Thank you, Senator Bartlett.

Senator BARTLETT. Thank you, Mr. Chairman and members of the committee.

Senator BYRD. I will call next on the Senator from Vermont, Mr. Leahy, but before he testifies, and with his permission—will you come forward, Senator Leahy?

Before your testifying, would you mind if I called on Congressman Waggonner to make a statement, because he has an important meeting in the House of Representatives at 10 o'clock.

Senator BYRD. Mr. Waggonner, we are glad to have you here.

STATEMENT OF HON. JOE D. WAGGONNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Representative WAGGONNER. I would just like to file a statement in support of S. 2228, and the House counterpart, H. 51261, which is a bill to permit employees to adopt new tax plans on a pretax basis.

[The prepared statement of Congressman Waggonner follows:]

STATEMENT OF HON. JOE D. WAGGONNER, JR.

Probably the most critical and immediate result of the enactment of ERISA has been one that no one intended—a drastic increase in termination of tax qualified retirement plans, and a decrease in the adoption of new plans. This trend poses a serious problem for the retirement security of workers throughout the United States.

As a member of the Subcommittee on Social Security of the House Ways and Means Committee, I am acutely aware of the need to preserve and stimulate the private pension system to relieve pressure on our overburdened social security system. In 1975 only 46.2 percent of all wage and salary workers were covered by retirement plans. There is much room for improvement in pension plan coverage.

ERISA brought reforms to the private pension system which were long overdue. At the same time, however, it created confusion, complexity and administrative burdens which have in some degree defeated the intended goal to strengthen the private pension system. It is time for Congress to take the initiative to rekindle employer interest in the private pension system.

I know of no better first step to foster the establishment of more private pension plans than the enactment of S. 3288 and its House counterpart H.R. 12561, of which I am a co-sponsor. This bill will solve a number of serious problems in the private pension system caused by ERISA, in a simple, fair and administrative manner. Equally important, it will provide a powerful, new incentive to create new plans.

This bill will permit an employer to adopt a new tax qualified retirement plan by sharing the initial cost impact with his employee on a pre-tax basis. A similar approach, the salary reduction plan was the means by which small employers had established new plans until ERISA foreclosed that approach. Enactment of S. 3288, will recreate this system which significantly contributed to the growth of the private pension system.

In addition to creating an incentive to establish a new plan, the bill also provides greater benefits to those employees already covered by qualified plans. By providing a limited deduction for employee contributions to a qualified plan, employees who are in low-benefit retirement plans, or who change jobs frequently and, therefore, never vest, will have a method of accumulating adequate retirement coverage as a supplement to their social security benefits.

I urge this Subcommittee to endorse this bill, and to explain to the Finance Committee its advantages. These advantages will be developed in detail by the distinguished panel of witnesses who are here to speak today on behalf of S. 3288.

Senator BYRD. Thank you very much, Congressman Waggonner. Your statement will be inserted in the record in full and let me say at this point that this committee—I think I can speak for the entire committee—is very sorry that you have decided to retire from the Congress. We know firsthand of the tremendous contribution that you have made to the American people through your membership on the Ways and Means Committee, and this Committee particularly will miss you a great deal.

Senator Leahy, you may proceed as you wish.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator LEAHY. Thank you, Mr. Chairman. I appreciate the opportunity to be here this morning and I appreciate the courtesy of yourself, Senator Long and Senator Curtis in arranging for me to be here on very short notice.

I have, Mr. Chairman, on my left—your right—Robert Beausoleil from the Vermont Timber Truckers Association in Lyndonville, Vt. Mr. Beausoleil came down here yesterday from Vermont, I might add, not to enjoy the fine weather of Washington, D.C., as compared to Vermont's summer weather, but rather to testify on a matter of great concern to him.

On my right, your left, is Ken Rolston of the American Pulpwood Association here in Washington, D.C.

If I could just take 30 seconds, I am here personally with them because the matter that they will speak of is of great concern to me. The IRS has taken action which, if followed through, will in effect put out of business any small logging operation, whether it is in the State of Vermont or Virginia or Nebraska or anywhere else. It would put it out of business.

The logical followup of this action would, I think, spell the deathknell to small business, and to independent contractors of any sort, anywhere in the country. And so I woud like, if I could, Mr. Chairman, having stated my own concern about this—and I will be filing further material with the committee and hope to be speaking to individual members of the committee subsequently—to yield to Mr. Beausoleil who has a statement that he wishes to put into the record.

STATEMENT OF ROBERT BEAUSOLEIL, PRESIDENT, VERMONT TIMBER TRUCKERS AND PRODUCERS ASSOCIATION

Mr. BEAUSOLEIL. Thank you very much, Senator.

Mr. Chairman, members of the committee, I would like to tell you a little bit about what has happened in Vermont. The Vermont Timber Truckers and Producers Association was formed to fight with the impending assessments by the IRS. We started to defend a couple in Sheffield, Vt.—Reginald and Barbara Dwyer. They are members of the school board, the Board of Selectmen and members of the church in Sheffield, a small town in the County of Caledonia.

They fulfilled all their religious and civic responsibilities in the community.

Reginald and Barbara have been assessed by the IRS for independent contractor relationships to the tune of $18,500. This $18,500 is approximately the net worth of 20 years of work of Reginald and Barbara Dwyer.

The IRS audited Reginald Dwyer early in the 1970's—I believe for 1970, 1971, and 1972. He filed as an independent contractor. Everyone associated with him did. They (the IRS) made no question of the status at that time.

Reginald went on, and in 1977, they then gave him an assessment after auditing him for something they had OK'd before.

This has had a devastating effect on the lives of Reginald and Barbara Dwyer. They have——

Senator CURTIS. Mr. Chairman, could I interrupt for a minute?

Senator BYRD. Yes.

Senator CURTIS. Now, this is a problem where it relates primarily to social security taxes?

Mr. BEAUSOLEIL. Well, social security and the income tax. As a matter of fact, the income tax and withholding is far worse, with penalties——

Senator CURTIS. Yes, but you have had a business arrangement where, for some years, they have gone on the basis that the person involved was in business for himself as an independent contractor. Is that right?

Mr. BEAUSOLEIL. Yes, sir.

Senator CURTIS. Then the Treasury comes in and audits and says he is not an independent contractor but has an employer-employee relationship?

Mr. BEAUSOLEIL. Yes, sir.

Senator CURTIS. And in that case, the employer would be liable for the social security tax, as well as its effect on the income tax?

Mr. BEAUSOLEIL. Yes, and the income tax and the Federal unemployment tax.

Senator CURTIS. Now, how many years did they go back and assess these deficiencies?

Mr. BEAUSOLEIL. With Reginald and Barbara Dwyer, 3 years.

Senator CURTIS. Have there been some where they have gone back farther?

Mr. BEAUSOLEIL. We have heard of some where they have gone back further, but not in Vermont, so far.

Senator CURTIS. The problem you are addressing yourself to is just across-the-board in our economy. Many filling station operators thought they were independent operators, and those in the insurance field, and others in direct selling of all kinds. And, in some instances, I understand that the claims of the Treasury go back more than 3 years.

Mr. BEAUSOLEIL. In some cases that we know of, especially for the fishermen, Senator Curtis, they had said that, well, the filing was wrong, therefore it was fraudulent and therefore there is no statute of limitations. I believe there is a bill in the House now to protect three fishermen in Massachusetts, New Bedford, Mass., that they all of a sudden decided this winter that they were going to go beyond the 1970 protection of the fisherman bill.

Senator CURTIS. Has there been some instances where the Treasury has audited and has not raised the question about the arrangement, where they have assumed the position of independent contractor and then at a later time reversed their own previous——

Mr. BEAUSOLEIL. Yes, sir. They did that in the Dwyer case. They did that in my case. I believe they have done that in the case of the Bennetts in Buckfield, Maine. I believe they have done that in the case of Peronto in Westmore, Vt.—Peronto was frightened and he borrowed the money and paid them, and is now still doing what he always has done, which is the way it has been done in the logging industry in Vermont since 1769.

Senator LEAHY. Mr. Chairman, if I could just interrupt in possible answer to what Senator Curtis has just asked, our State was the 14th

State to be admitted to the Union. As Bob has just said, we have always done it this way. There is a history of the loggers being considered independent contractors.

The problem is that the IRS appears to be acting arbitrarily here, and in a retroactive fashion contrary to the mandate of the 1976 Tax Reform Act. We are talking about small businesses that cannot afford accountants, lawyers and everything else to fight this thing every single time.

There is so much confusion involved that a lot of them are not going to operate at all. They are not going to operate at all. They are not going to carry out the kind of work that has been carried out traditionally in those areas for 200 years.

The ripple effect in a small, rural State like ours is devastating because, in many of the areas of our State, this is the sole economic activity, and it is just stopping.

I think it is safe to say that a number of people, rather than run the risk of being clobbered a year or two from now, just will not operate at all.

Senator CURTIS. Now, have some of these demands by the Treasury for more money occurred since 1976?

Mr. BEAUSOLEIL. Yes, sir. They are going on right now. There are audits in process right now.

Senator CURTIS. This problem has been before the Congress for a long time, and so many questions have been raised in so many different industries in so many different States, that in the conference report of the Tax Reform Act of 1976 we inserted a provision which said, in substance, that the Joint Committee would study this problem and, in the meantime, we asked the Treasury and the IRS, to lay off during the time we looked into this. But apparently, that has not happened.

Mr. BEAUSOLEIL. Senator Curtis, I believe that they have increased this type of audit, and I would like to go back just a minute before I forget, in reference to the changed position you just asked about.

Reginald Dwyer got his assessment—and our organization hired an attorney whom we have not yet raised enough money to pay—but that is immaterial. The attorney went to the first hearing with him, and with two Supreme Court decisions, three appeals court decisions. They had to admit that these independent truckers, with trucks that cost $80,000 and $90,000 were independent contractors.

A month later out of the same office, I got my assessment. The same truckers had been named my employees. I had the same attorney that they sent the letter to admitting that these truckers were independent contractors, and they have been named my employees and the assessment is something like $45,000.

Senator CURTIS. When did this happen?

Mr. BEAUSOLEIL. I think I got my assessment at the end of February, sir.

Senator CURTIS. 1978?

Mr. BEAUSOLEIL. Yes.

This has had a devastating effect. There is a large farm, the King George Farm that cuts pulp, and I buy the pulp from them and I have two truck drivers who are employees—not independent contractors. I had to stop one truck this spring because I did not have enough work for it. I would have had plenty of work for it, but King George

Farm will not cut any pulp until this issue is resolved. They are not going to get into this mess.

Stanly Switzer sold his skidder. Stopped—not going to get into this again.

So the ripple effect of this has been tremendous. Right now the mills in Vermont are short of logs. We have several people, including Reginald Dwyer, who will not contract with anybody anymore. He is a good family man, father of three children. He is now working in the woods alone—which is very dangerous—but he will not have anything to do with contractors until this is solved.

Senator LEAHY. Mr. Chairman, I wonder if the full statement of Mr. Beausoleil could be made a part of the record, and also the full statement of Mr. Rolston.

Mr. Rolston and his American Pulpwood Association have been extremely helpful to us in Vermont. We would not have come along as far as we have in preparing testimony and all without his help and the help of his association.

Senator BYRD. Yes, both statements will be inserted in full in the record, and I might say to you that you have a very fine sponsor and a strong advocate in Senator Leahy.

Mr. BEAUSOLEIL. Thank you, sir. We know that, too.

Senator BYRD. There will be a panel discussing this same issue later on in this hearing. The committee, of course, will want to get the position of the Treasury Department, but instead of asking the Treasury testimony at this point, I think I will delay until the panel presents its views.

Thank you, Senator Leahy.

Mr. BEAUSOLEIL. There is one thing. We really feel that we need the language in the Pinetta bill to protect the Vermont loggers.

[The prepared statements of Messrs. Beausoleil and Rolston follow:]

STATEMENT OF ROBERT J. BEAUSOLEIL

Thank you, Mr. Chairman and members of the Committee, for giving me the opportunity to testify at this hearing on the bill calling for curbs on certain Internal Revenue Service activities which we believe to be inconsistent with the desires of the Congress. I am Robert Beausoleil from Lyndonville, Vermont. I have a logging and pulpwood business and I am the president of the Vermont Timber Truckers and Producers Association, a year-old organization with about two hundred members, most of them loggers, truckers, and sawyers.

Senate bill 3007 provides that the IRS shall not apply any new or changed position in the general area of employment tax audits of businesses until Congress acts. It is unfortunate that it has been necessary to write and to introduce this bill at all, because the Joint Committee on Taxation's Conference Report of September, 1976 on "The Tax Reform Act of 1976" urged the IRS not to do what this bill S. 3007 would prohibit the IRS from doing. However, the IRS has not responded well to the urgings of Congress, so I am here to support the intent of this bill.

I have been in the logging business in Vermont for eighteen years. I started working by myself with a chainsaw. Soon I bought a bulldozer, and I have gradually increased the size of my operation to the point where I now have six employees. In addition I contract with half a dozen or so people for logging and trucking services, and I buy wood from 10 or 15 vendors. As you can see, my operation has grown, but it is still small. I mentioned that I both hire employees and use independent contractors, and this has been the case in my operation since the beginning. To determine the employment status of a logger or trucker I have always used as the principal criterion the degree of control that I exerted over him. If I expected to determine his hours, rate of productivity, and methods of working, I treated him as an employee for tax purposes. If he determined those things for himself, I treated him as an independent contractor. This was the usual practice in the industry, and we had every reason to believe that this was also the way the IRS wanted it. I was previously audited by the IRS for the years 1967, 1968 and 1969 without being assessed for employment taxes on the independent contractors and vendors with whom I do business.

Now, after continuing to do business as I always have, and in accordance with the accepted practice in the logging industry in our area since its beginning, I am appealing an assessment of $98,000 for employment taxes on the independent contractors and vendors with whom I have done business. Included in this group are a real estate broker from whom I bought some pulpwood, the owner of a rubbish removal service from whom I bought some pulpwood, farmers from whom I bought wood, a stockbroker from whom I bought a single load of wood, and logging and trucking contractors with whom I had done business for varying amounts of time. The IRS says that all of these people are my employees. At the same time, the IRS says that it has not imposed any new or changed position. Don't you believe it.

If the IRS had sought legislation abolishing independent contractors and vendors and making nearly every payee in a business transaction an employee, I would have opposed it; but if after public debate Congress had passed any such legislation, of course I would have complied with it. However, instead of seeking to bring about this change in the way provided for bringing about such changes, the IRS is attempting to accomplish it without having to take the trouble to go through Congress. We hope that you will not let this happen.

Over the past year I estimate that I have spent about one-half of my time on activities related to this issue. I have had to hire attorneys and accountants to do work that advances my business in no way, but if successful will simply keep me even. It has been, and continues to be, a considerable drain on my small business to divert so much energy into this battle. And I must do this in spite of the fact that numerous court decisions have held that in operations similar to mine the contractors are, in fact, contractors—not employees. (See, for example, *Grady Felker* v. *U.S.*, *Modisette* v. *U.S.*, *C. S. Jones* v. *U.S.*)

I wish that my friend and associate of many years, Reginald Dwyer of Sheffield, Vt., could be here to tell you about his case. Reg is a small logging contractor, honest and hard-working, who also survived a previous IRS audit without being assessed employee taxes on the men with whom he contracts for logging and trucking. However, last fall Reg was assessed $18,000 for employee taxes on independent contractors. If Reg were here today, he would tell you that the IRS has indeed applied a new position to him.

Because of my experience with the IRS and because of others that I know of, I applaud the intent and purpose of this bill S. 3007, and any other bills that will give relief to members of other industries with the same problem that we have. However, I have recently become aware of a House bill, H.R. 13313 introduced by Congressman Panetta, which I think expresses the purpose even more clearly. In subsection b, H.R. 13313 says, "An individual would not be treated as an employee of any person if the latter, in good faith, consistently treated such individual as an independent contractor." I feel certain that this language from the Panetta bill would provide some relief for me; for eg Dwyer; for Paul Daniels of Irasburg, Vermont; for Roland Bennett of Bucksfield, Maine; and for all the others who are being harassed by the IRS on this issue. I respectfully urge you to adopt this language into your bill and then to report favorably upon it. We need this relief until a more permanent solution to the problem can be found, and we hope that we can be of some assistance in finding such a solution.

Statement of the American Pulpwood Association [1]

The members of the American Pulpwood Association are producers and consumers of pulpwood, the basic raw material for paper manufacture. My name is Ken Rolston, and I am the Executive Vice President of the Association. We want to express our support for Senate bill 3007, introduced by Senator Dole, a bill which would provide interim relief for certain taxpayers whose status as independent contractors has been questioned by the Internal Revenue Service in a manner inconsistent with the Service's position prior to 1976. We believe that the source of the current problems concerning independent contractor status

[1] 1619 Massachusetts Ave. NW., Washington, D.C.

is the recent use by the IRS of a new interpretation of what constitutes employment that is inconsistent with traditional common law principles. Before the IRS initiated audits and assessments founded upon this new interpretation, the common law definition of independent contractor served the public and private interests clearly and equitably.

A number of our members from the pulpwood production side of the industry, known as logging contractors and pulpwood dealers, are in various stages of the Internal Revenue Service process from audit through to assessment, administrative appeal, and some are in federal court. The variety of circumstances of these cases is extreme, but all hinge on IRS contention that for tax purposes, an employment relationship existed despite a preponderance of common law test evidence that the relationship was independent and that employment status was not contemplated by the parties involved.

In our industry we have a number of cases with extremely similar fact situations where the IRS contends that log-cutting contractors are employees of those to whom they sell their products or harvesting services. Three of these cases have been taken to court by the taxpayers and been ruled to be independent. The IRS continues to pursue the others, disregarding these legal precedents. I feel certain that all such situations in our industry which reach the courts will be judged independent under the common law independent contractor principles. Legislation is necessary to curb IRS actions until such time as the Congress will act to return the IRS to proper application of the common law.

We also believe legislation is necessary because the Internal Revenue Service has, in our opinion, not heeded the urging of the Senate Committee on Finance in 1976 that it not apply changed or newly stated positions until the completion of a study by the staff of the Joint Committee on Taxation. The IRS now must be more fully instructed by legislation to hold position until Congress prescribes a long range solution.

The language of S. 3007, as we understand it, would freeze the status of some classes of taxpayers and save them from, at worst, bankruptcy and in other situations, heavy attorney's fees when IRS actions may not be justifiable under legislation which Congress shall eventually pass to clarify the situation.

Several of our members have been assessed without reference to any revenue ruling applicable to forest harvesting, and some have been assessed without reference to any revenue ruling. These taxpayers relied largely upon consistent federal and state court decisions specifically applicable to their businesses, holding that the businessmen from whom they purchased goods and services were independent contractors. Nevertheless, the IRS has assessed on factual circumstances virtually identical to decided matters, in effect, disregarding this nation's courts. Therefore, we suggest that consideration be given to temporary relief for those taxpayers under employment tax audit or retroactive assessment where restated or changed IRS rulings may not be the primary factor.

We urge that you consider amendment of the bill to include relief for situations where the taxpayer in good faith has consistently treated the individuals in question as independent contractors or self employed persons. We believe that this or similar language would provide more comprehensive disincentive to the Internal Revenue Service in their current quest to find employment relationships, where none exist under common law nor were intended by the parties involved, purely for improving the mechanical ease of tax collection. We suggest to the Committee the wording in H.R. 13313 which we feel would more fully provide protection for taxpayers facing IRS action based on new or changed policies.

Beyond the purpose and intent of this legislation, we support the retention of the common law principles and their reinstatement in IRS policy and procedure. Proper enforcement of the law and use of existing compliance tools, coupled with an enlightened educational effort, would be more than sufficient to provide equity for all concerned.

I appreciate the opportunity to appear before this committee.

Senator BYRD. Our next witness will be the Senator from Arizona, Senator DeConcini.

Senator DeConcini will appear on behalf of S. 3037.

Welcome, Senator DeConcini.

STATEMENT OF HON. DENNIS DeCONCINI, A U.S. SENATOR FROM THE STATE OF ARIZONA

Senator DECONCINI. Mr. Chairman, thank you very much. I welcome the opportunity to appear before you this morning to explain the objectives of 3037, which is slightly different than 3007, although both of them are worthy of your consideration.

Senator Haskell and I introduced this measure on May 24. Since that date, Senators Johnston, Huddleston, Bentsen, and Hatch have joined us as cosponsors.

S. 3037 has quite a limited aim. It is designed to redress certain inequities affecting the real estate industry which have grown out of the confusing and discontinuous policy surrounding the definition of occupational status for tax purposes.

As you know, Mr. Chairman, the question of whether an individual is an employee or an independent contractor poses some of the most difficult issues of public finance and tax administration. Nor is this a matter of abstract taxonomic interest. The resolution of such issues is fraught with substantial tax consequences.

Historically, policy in this area has been set via the interaction of common law, precepts, IRS rulings and litigation. Predictable results have been excessive complexities, and increasing policy incoherence. The problem, of course, is exacerbated by the rapid change in structure and function characteristic of our economic system.

Thus, the need for statutory intervention is, by now, widely conceded.

It is for this reason that this committee and its counterpart in the House commissioned a staff study of the issue in question in the Conference Report on the Tax Reform Act of 1976. The findings of this inquiry were to serve as the basis for framing a comprehensive and workable legislative remedy.

That study is now complete and, as I understand it, the process of developing a more rational policy is underway. In any case, the committee's clear intention was to forestall rulemaking in this area until a congressional solution could be devised and adopted.

Accordingly, in that same conference report, IRS is urged—and I quote from the report—

> Not to apply any change in position or any newly stated position which is inconsistent with a prior general audit position in this general subject area to past, as opposed to future, taxable years until the requested staff study has been completed.

The conference report containing this language was adopted September 13, 1976. Since that date, the IRS has suspended rulemaking in this area.

The problem, however, is that a few months prior to the conference report's adoption, to be exact, on April 12, 1976, the Service issued two classification rulings affecting the tax status of real estate agents. It was clearly the intent of the Congress, Mr. Chairman, that further rulings of this sort be held in abeyance until the general problem is resolved. The Service, through, has been adamant in its contention that this directive does not apply until after the conference report was adopted in September, even though the Senate committee report which was filed June 10, 1976, contained identical language. It hardly seems fair to single out real estate agents in this way for separate and adverse tax treatment.

The bill before you would simply require the IRS to extend its suspension on further rulemaking in this domain back to January 1, 1976, the effective date of the Tax Reform Act of 1976. The effect would be to return the tax treatment of the real estate industry to the status quo ante revenue ruling 76-136 and 76-137. Thus, whether a salesperson is an employee or an independent contractor would, under this bill, continue to be determined in accordance with longstanding judicial precedent and well-established Treasury guidelines.

The real estate industry has operated under these rules since the early 1950's and should be allowed to continue to rely on those principles until such time as Congress enacts general legislation on the entire question.

I thank the chairman and the committee for considering this very crucial legislation, and I also support 3007 in general.

Thank you, Mr. Chairman.

Senator BYRD. Thank you, Senator DeConcini. That is a good statement.

Senator Curtis?

Senator CURTIS. I have no questions. We have covered the points.

Senator DECONCINI. Thank you very much, Mr. Chairman.

Senator BYRD. Thank you, sir.

The next witness will be the Senator from Alabama, Senator Allen.

Senator Allen, will you come forward?

Welcome, Senator Allen. I understand you will testify on S. 3080.

Senator ALLEN. Yes, sir, and because we have so much business today, I thought I would be very brief.

STATEMENT OF HON. MARYON ALLEN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator ALLEN. Mr. Chairman, I am delighted to have the opportunity to testify before the Subcommittee on Taxation and Debt Management in favor of S. 3080, as introduced by my late husband, Senator James B. Allen, to amend the Internal Revenue Code of 1954 to exclude certain services performed on fishing boats from unemployment compensation. This proposed legislation would serve to correct an inequity which presently exists in the Internal Revenue Code with reference to the fishing industry.

This legislation you are considering will exclude these boat owners and operators from the excessive burden of paying unemployment tax on those crewmen defined as being self-employed under the Tax Reform Act of 1976 and will bring some consistency in the enforcement of, and compliance with, these two laws.

Employers need some relief from excessive government intervention and regulation. Enactment of S. 3080 would be tax reform in its purest sense. Tax consistency would be a welcome reform, and a welcome relief.

Therefore, it is my hope that the Subcommittee in its wisdom would seek to recommend the enactment of this legislation which is of such vital importance to the fishing industry in Alabama—and I would like to add that it would affect all other States who have fishing industries with smaller crews, like shrimp fishing.

I would like to submit, Mr. Chairman, the full statement.

Senator BYRD. Yes, thank you, Senator Allen. Your full statement——

Senator ALLEN. I thought you had so much on the agenda today that it would be very welcome if I did not read all of this.

Senator BYRD. That is very considerate of you, and your full statement will be published in the record at this point.

Senator ALLEN. Thank you and I will not impose upon you any more.

Senator BYRD. Senator Curtis?

Senator CURTIS. We thank you for your appearance, and just one question.

Is it your understanding that, if the language as originally written in 1976 was construed in the manner that the Congress had in mind, would it have taken care of your problem, or do you need an amendment?

Senator ALLEN. Well, the thing was, Senator Curtis, that the inconsistency is that they declare a man self-employed under one act and then they claim, in this other one, that the same man is an employee, and it is very confusing to the owners and to the men alike, because so many times these are just pickup crews that they employ for a few hours, or a day or two at the very most.

And so it is very confusing when these men really, in essence, are self-employed. They are not attached to one crew for long periods of time.

Senator CURTIS. Thank you.

Senator ALLEN. Thank you.

[The prepared statement of Senator Allen follows:]

STATEMENT OF SENATOR MARYON ALLEN

Mr. Chairman, I am delighted to have the opportunity to testify before the Subcommittee on Taxation and Debt Management in favor of S. 3080, as introduced by my late husband, to amend the Internal Revenue Code of 1954 to exclude certain services performed on fishing boats from unemployment compensation.

This proposed legislation would serve to correct on inequity which presently exists in the Internal Revenue Code with reference to the fishing industry. Under the Tax Reform Act of 1976, criteria were established under which certain crewmen would not be considered employees of the owner or operator of the fishing boat. In effect, the Internal Revenue Service has declared shrimp boat crews to be self-employed provided that, (1) the crewman does not receive any cash renumeration, (2) the crewman receives a share of the boats' catch of fish or a share of the proceeds from the sale of the catch, (3) the amount of the crewman's share depends on the amount of the boats' catch, and (4) the operating crew of the boat is normally made up of fewer than ten individuals. These criteria were made applicable for purposes of withholding Federal tax and Federal Insurance Contributions Act tax; and consequently, exempts the employed, in this case the boat owner, or operator.

It is interesting to read the Report language of the Senate Committee on Finance contained in report 94–938 on the Tax Reform Act of 1976, regarding their decision as to treatment of those individuals employed in fishing as reflected in Sec. 1207 of H.R. 10612. Prior to the enactment of the Tax Reform Act of 1976, the Internal Revenue Service treated individuals employed on fishing boats as regular employees. As a result, operators of the boats were required to withhold taxes from the wages of the crewmen as well as deduct and pay taxes as employees and employers under Social Security.

In its rationale for exempting employers from these taxes, the Committee concluded that crews working on boats used in fishing, such as taking shrimp and lobsters, are frequently "pick-up" crews composed of individuals who may work for only a few voyages, and sometimes even for only one voyage. It was pointed out that in some cases, the boat operator might select his crew from individuals found waiting on the dock in the mornings. In other cases it was found that small boats might be operated by relatives, no one of whom is considered the boat operator, "captain," or even the crew's leader. In such instances the voyage, as it were, became more of the nature of a joint venture than one of an employment situation.

The committee report states,

"Under those circumstances, it is difficult and impractical for the boat operator to keep the necessary records to calculate his tax obligations as an employer, and it is equally difficult for him to withhold the appropriate taxes for payment. Often these boats operate with small crews, and the boat operator himself is likely to be an individual who has worked as a fisherman throughout his career, and who is unaccustomed to keeping records of any type, especially the type required under the tax rules for employers." (p. 385)

Another contributing factor to the special consideration given to these boat operators is the nature of the remuneration paid to their crewmen. In many cases, the crewmen are paid no regular salary but instead receive a portion of the catch. There are times when the catch is sold upon return to shore, usually by the boat operator, and subsequently each crewman is immediately paid a percentage of the proceeds of the catch equivalent to the portion of the catch for which he had agreed to work. Taking all of these arguments into effect the Committee stated:

"In view of the basic informality of these arrangements, and the consequent difficulty in adhering to the obligations required of employers by the Internal Revenue Code, (and) believes it appropriate to remove these obligations from certain small boat operators by treating their crewmen as self-employed individuals. The Committee believes that this will recognize the basic nature of the arrangement between the boat operators and the crewmen since the crewmen, under these arrangements, should find it much simpler and more convenient to calculate and report their own income for tax purposes than do the boat operators." (p. 385)

As a consequence, this amendment included in the Tax Reform Act of 1976 provides that boat crewmen under the aforementioned circumstances should be treated as self-employed for purposes of income tax withholding from wages, the self-employment tax, and social security taxes. As a part of this amendment, the committee did require boat operators to report the identificaton of the self-employed individuals serving as crewmen, as well as the portion of the catch allotted to that individual. The boat operator is also required to report the percentage of his own share of the catch and to provide each of the self-employed crewmen a written statement on or before January 31 of the succeeding year showing the information reported by the boat operator with respect to that crewman for the proceeding calendar year contingent upon the crewman's supplying the boat operator with a location at which he would receive the return statement.

These relief provisions to the fishing industry for social security tax and income withholding tax liabilities by redefining "employment" in Sec. 312(b)(20) and "wages" in Sec. 3401(a)(17) of the Internal Revenue Code were granted retroactively to December 31, 1971, against imposition of assessments for these two taxes, (26 USCA (Pocket Part) paragraph 3121(b) page 220).

Mr. Chairman, the same arguments and the same rationale for excluding the boat owners and operators from the necessity of withholding income taxes and the withholding of and payment of social security taxes can be applied to their proposed exemption from unemployment taxes. The fact that unemployment tax liability for the fishing industry was not included in the 1976 Tax Reform Act was in my judgment an obvious oversight by the Congress which S. 3080 intends to cure.

The Committee further modified the provisions of their original language dealing with crewmen on fishing boats in its supplemental report (94–938, part 2) on the Tax Reform Act of 1976, dated July 20, 1976, by expanding its definition of self-employed individuals to say that:

"All crewmen on fishing boats (or boats engaged in taking other forms of acquatic animal life) are to be treated as self-employed individuals if the operating crew of the boat upon which they serve, normally consists of fewer than ten individuals, and also if the sole renumeration of these crewmen consists of a share of the catch of the boat, or, in the case of an operation involving more than one boat, consists of a share of the catch of the entire group of boats." (p. 65)

It is inconsistent, Mr. Chairman, to require the employer in this case the boat owner, or operator, to pay unemployment taxes on those who, under the Tax Reform Act of 1976, are classified as self-employed. The self-employed are not eligible to collect unemployment compensation. Though these are different taxes, there is no reason for inconsistency in exemptions. If a person is considered self-employed under the criteria of the one, there is no reason why an employer should be required to pay unemployment tax on that self-employed individual. Exclusion from coverage under the Federal Insurance Contribution Act (FICA) should be extended to mean an exclusion from coverage under the Federal Unemployment Tax Act (FUTA). Either a man is self-employed or he is not. It is inconsistent to declare a crewman self-employed under one act and claim that same man as an employee of the boat owner or operator under another act.

To further corroborate the argument for employer relief from FUTA taxes are the provisions of the Technical Corrections Act of 1978, H.R. 6715, which passed the House under Suspension of the Rules on October 17, and designed to correct technical and clerical mistakes in tax laws. Though not yet passed by the Senate, the bill was reported to the Senate by the Finance Committee on April 19, 1978 (S. Report 95-745). This legislation carries a provision reported in Section 2(aa), which rides the relief provisions for the fishing industry from December 31, 1971, as provided for in the Tax Relief Act of 1976, back to 1954. However, once again, the Technical Corrections Act of 1978 affects only social security and income withholding tax liabilities for the fishing industry. Similar relief provisions for FUTA tax liabilities have not been included in either of these acts, Mr. Chairman, an obvious oversight by the Congress which S. 3080 intends to cure.

Since the intent of this legislation, S. 3080, is to bring consistent relief to the fishing industry and since I have become aware of the provisions of the Technical Corrections Act of 1978 carrying the relief provisions for social security and income withholding tax liabilities back to 1954, I would suggest the effective date of S. 3080, January 1, 1978, be amended to include a similar provision for retroactive effectiveness of the FUTA exemption so that the fishing industry will be uniformly relieved from liability for all three taxes.

In reading Senate Report 94-938, Part One, a short paragraph on page 385 caught my attention. The Committee stated:

"In treating these situations as instances of employment of crewmen by boat operators, the Internal Revenue Service has not only required current payment of employment taxes by the boat operators, but has also assessed these taxes retroactively for all tax years still open under the Statute of Limitations. *As a result of possible sizeable assessments, many boat operators may face bankruptcy.*"

The same situation exists for the boat owners and operators regarding the FUTA tax, Mr. Chairman. S. 3080 would simply amend Section 33061 c) of the Internal Revenue Code (relating to the definition of employment under the Federal Unemployment Tax Act) by using the same criteria to determine self-employment of the crewmen for unemployment tax purposes as used to determine self-employment of the crewman under the Tax Reform Act of 1976.

There should be no apprehension that the proposal or enactment of this legislation smacks of indifference or callousness with reference to the crewman. There is no conspiracy to deny the crewman benefits. Shrimp boats and other fishing boats can be worked the year round in many instances. It may not be pleasant to work in the winter months as it is in the summer months, but the jobs are still there and those who have the incentive and will to work, have ample opportunities to do so.

Finally, Mr. Chairman, this legislation would consequently exclude these boat owners and operators from the excessive burden of paying unemployment tax on those crewmen defined as being self-employed under the Tax Reform Act of 1976, and bring some consistency in the enforcement of and compliance with

these two laws. Employers need some relief from excessive government intervention and regulations. Enactment of S. 3080 would be tax reform in its purest sense. Tax consistency would be a welcome reform and a welcome relief. Therefore, it is my hope that the Subcommittee in its wisdom, will see fit to recommend the enactment of this legislation which is of such vital importance to the fishing industry of Alabama.

Senator BYRD. The committee will want to know the position of the Treasury Department, but instead of seeking it now, there will be another witness on this measure, so I think it would be well to delay until the second witness has testified.

The next witness will be the Congressman from California, Mr. Panetta.

I am glad to have you, Congressman Panetta.

Representative PANETTA. Thank you, Mr. Chairman.

STATEMENT OF HON. LEON E. PANETTA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Representative PANETTA. I appreciate the opportunity to testify. Having served here in the Senate for 3 years as a legislative assistant to then-Senator Thomas Beakle, it is always a pleasure to come back, just to come before this body.

Senator BYRD. We are glad to have you back.

Representative PANETTA. I am going to ask unanimous consent that my statement be incorporated in the record.

Senator BYRD. Without objection, it will be incorporated in the record.

Representative PANETTA. I would like to summarize my comments for you.

This is an issue that has been addressed by other witnesses and it relates to the independent contractor-employee issue.

Obviously, the key elements of an efficient tax system are that the tax laws have to be clear, they have to be certain and they should not be subject to arbitrary interpretation, either by the taxpayer or by the Government. Under present tax laws, it is very clear that who is a self-employed person and who is an employee has become an area that is not clear. It is extremely ambiguous and extremely arbitrary.

Traditionally in thousands of businesses, people have labeled themselves as self-employed. In the direct selling area, for example, for a large number of years—70, 80 years—people in this area have labeled themselves as being self-employed. This is true for real estate agents. It is true for insurance agents. It is true for beauticians, for barbers, for service station operators, for a number of others engaged in small businesses in this country.

And, as a result of that, they file their self-employment taxes, they file their estimated income taxes, they provide for their Keogh plan and suddenly the IRS comes in and says, no, you are not independent contractors, you are really employees. The employer, as a result, is hit with additional withholding taxes, Social Security taxes, to the tune of thousands of dollars.

In some instances we have had examples where the penalty imposed on the business, in effect, outweighs the value of that business. We have had bankruptcies resulting from this, businesses that have gone out of existence. We obviously had double taxation that is involved in this area.

This has been confirmed in a number of reports. The GAO in November of 1977 indicated that this was an area that was unclear and very ambiguous, suggesting some remedies on their own. As a matter of fact, the Treasury Department itself in response to that GAO report confirmed that this was an area that demanded clarification.

In the Congress itself, as the Senators have pointed out, in 1976 in the Tax Reform Act, directed that the IRS withhold from proceedings until Congress came up with a clear definition of who was an independent contractor and who was an employee.

There is no question that a clear definition is required. The problem is, what happens in the interim? This is a grey area.

Having practiced law in this area, it is clearly a difficult situation under the common law to come up with clear definitions of who is an independent contractor and who is an employee, and obviously, it is the task of this committee and the committee over at Ways and Means to try to come up with that long-term definition.

The problem is, what happens in the interim? How does IRS proceed?

The legislation that I have introduced in the House is aimed at trying to provide an interim response. The first bill that I introduced is essentially that introduced by Senator Dole and also Senator DeConcini, which would require that the guidelines in effect in 1975 be applied by IRS, and not resort to new interpretations that have taken place since 1976.

Another bill I have introduced would essentially allow a person to be labeled an independent contractor if that is what he has been labeled in good faith, and consistently, in the past.

Either one of those interim approaches, I think, is absolutely essential to try to stop the IRS from continuing to proceed to, as I said, arbitrary interpretations in this area.

This is, I think, in the public's mind another example of the bureaucracy, deciding how laws Congress passed ought to be interpreted and ought to be applied and, in effect, making new laws.

I think it is our responsibility to make this area very clear and, in the interim, try to provide the kind of interim help that literally thousands of taxpayers must have if we are going to protect small businesses and those engaged in small businesses.

So I would refer the committee H.R. 12427 and H.R. 13313 for your consideration in hopefully developing an interim response to what is a difficult situation.

Senator BYRD. Thank you, Congressman.

Representative PANETTA. Thank you Senator.

Senator BYRD. Senator Curtis?

Senator CURTIS. We appreciate your testimony here and in deference to those who are to follow, I will not prolong this, but it does have a very wide application, does it not?

Representative PANETTA. It certainly does.

Senator CURTIS. Taxi drivers, real estate salesmen and may other business operations throughout the years have been operating on the basis of independent contractor arrangements. It is my understanding that it does not effect the actual income tax liability of the parties but it does cause expense and great inconvenience because they have to reconstruct their books on the basis of this new determination, and in some instances there might be some interest or penalties because of it. It also affects cash flow because it affects the withholding, even though there is no distinction between the tax rates on whether it was self-employment income or wages.

Do you concur in that?

Representative PANETTA. All of the points that you mentioned are correct. It is the restructuring, but it has also been my experience that the penalties themselves do not take into account the amount paid to the Government in self-employment taxes and the result is that you have cases of extreme double taxation.

And also, when you are facing that kind of penalty, you go back 3 years retroactively, that is a substantial sum to have to come up with all in one payment, and that is what really hurts most of these businesses.

Senator CURTIS. It is my contention that if a particular situation is treated in a certain manner over a long period of years, then it becomes the law by the law of usage and precedent. And if there are problems that arise or an injustice or any other factor that requires attention, then the Treasury should promulgate a remedy and bring it to the Congress and ask that it be enacted. But it should not by regulation change the obligations of taxpayers based on a concept which is different from what they have, in good faith, relied on over a period of maybe a great many years.

Do you concur?

Representative PANETTA. I think that is exactly right, Seenator.

I have had occasion to talk to Treasury employees in this area who have stated that it is a very arbitrary situation at the present time. Those agents in California, for example, say what they are adhering to is the Attorney General's interpretation in California, which could result in 50 different interpretations on what is an independent contractor and what is a self-employed person, or what is an employee.

I think this is a situation that just immediately demands the attention of the Congress.

Senator CURTIS. In addition to the hardships faced by the individuals directly involved, it creates a confusion throughout our economy that is detrimental to job-producing activities going forward. is that not correct?

Representative PANETTA. Exactly.

Senator CURTIS. No further questions.

Senator BYRD. Thank you, Congressman.

Representative PANETTA. Thank you very much, Senator.

[The prepared statement of Congressman Panetta follows:]

STATEMENT OF REPRESENTATIVE LEON E. PANETTA

Mr. Chairman and Members of the Subcommittee: I appreciate having the opportunity to speak to you about an issue which is of growing concern to business men and women throughout the country; namely, the tax status of the independent contractors. In addition, I want to applaud the efforts of Senators Dole, DeConcini, and Haskell for introducing legislation similar to the bill I have introduced in the House which would rectify this serious situation.

Over the past several years, there has been increasing anger within the business community over the arbitrary and inconsistent actions of the internal revenue service. Within the last three years, the IRS has attacked thousands of businesses where individuals whose occupations are real estate salespersons, barbers, beauticians, insurance agents, and service station operators work as independent contractors. By reclassifying such individuals as employees for federal tax purposes, the IRS is now demanding that firms pay additional payroll taxes, withholding taxes, unemployment taxes, and both halves of Social Security. This arbitrary labeling of self-employed persons as employees is forcing countless businesses into bankruptcy or into the courts. A situation which I feel is unwarranted and totally unacceptable.

I am here today to urge this subcommittee to move quickly to provide immediate relief to literally thousands of businesses who are being harassed by these arbitrary and inconsistent IRS audits. Although there clearly is a need for a long-term solution to this grey area in the law, I feel that S. 3007, S. 3037, H.R. 12427, H.R. 13313 or similar legislation would provide the type of immediate interim respite from recent IRS actions that the business community needs while more comprehensive legislation is being developed by the Joint Committee on Taxation.

This is exactly what the Congress said in 1976 when the conferees on the Tax Reform Act directed the Internal Revenue Service to withhold making any new interpretations of the law until Congress acted on clarifying the law itself. But the IRS has ignored this directive, unjustified audits continue, and we, as legislators, have our responsibility to represent the needs of our constituents.

In a time when virtually every business is threatened by the growth of big government, it is obvious to me that we cannot allow the Internal Revenue Service to pursue the course of action it is currently taking. The self-employed person is basic to a free economy. Therefore, it is imperative that the independence of the self-employed person be maintained through our tax system.

There are other issues involved in the debate over who is or is not an independent contractor which relate to the roles of the executive and legislative branches of government. Who, in fact, should be making the decisions about this complex issue? Should it be the Treasury Department, based on its need to collect additional tax revenues? Or, should it be the Congress, based on the needs and desires of individual taxpayers? It is my view and I think you will agree, that the latter is not only preferable, but is absolutely essential under the Constitution and our process of government.

The controversy surrounding the independent contractor issue has made our tax system increasingly inconsistent, confusing and inequitable. No longer can self-employed persons count on the right to make independent decisions about their lifestyles without government interference or harassment. As things stand now, the IRS can come in and retroactively reclassify any person as an employee and literally put him out of business. Or, it can tax the same person twice, since many times a broker does not have the information necessary to establish an offset. Let me repeat, this situation is unacceptable.

According to Adam Smith in Wealth of Nations, "The tax which each individual is bound to pay ought to be certain, not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person . . . The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequity is not near so great as a very small degree of uncertainty."

It is obvious that the tax status of the independent contractor is totally uncertain, both for the taxpayer and for the government. Thus, I would urge the members of this Subcommittee to consider this matter thoroughly, and in the meantime, to endorse a short-term legislative solution to the bills I have mentioned.

I feel that the support of 56 of my colleagues in the House who have agreed to co-sponsor my bills indicate the importance of this matter to the people of this country.

As you may know, Chairman Al Ullman of the House Ways and Means Committee has appointed a Task Force within the Committee to consider legislation in this area. I have discussed this matter with the Chairman of the Task Force, Charles Rangel of New York, and other members and they concur in the need for interim legislation pending the development of a long range proposal. I would urge the Subcommittee to follow the same course.

I want to commend the chairman and the members of the subcommitee for holding hearings today, and I want to offer my assistance in developing effective interim legislation to provide immediate relief to independent contractors in accordance with the previously expressed wishes of the House and Senate conferees on the Tax Reform Act of 1976.

Thank you.

Senator BYRD. Senator Hathaway; do you have a statement that you wanted to make?

Senator HATHAWAY. Thank you very much. I apologize for being late.

Senator BYRD. We are delighted to see you, sir.

Senator HATHAWAY. It took me 2 hours to get in this morning because of the transit strike.

STATEMENT OF HON. WILLIAM D. HATHAWAY, A U.S. SENATOR FROM THE STATE OF MAINE

Senator HATHAWAY. I appreciate very much the opportunity, Mr. Chairman, to testify in respect to S. 2128. I am happy to be a cosponsor of this bill with Senator Inouye and many others.

I am concerned about the economic security of our senior citizens. These are the people who have made this great country. They have made their contribution and now that they have retired from the working world, many of them are having a very difficult time getting along.

We have enacted many laws to assist them, and we have all wholeheartedly supported those, but I think there is something further we can do. Some further changes which are incorporated into S. 2128 will be of a great deal of benefit, particularly to those who are not the recipients of social security benefits which, as we know, are not taxable.

Now, an individual who is 65 years of age is allowed a tax credit of 15 percent of an initial maximum amount, depending on the taxpayer's filing status, less certain reductions. The maximum amount for credit computation is not limited to retirement income. All types of taxable income are eligible for the credit, including retirement income, personal services income and investment income.

Now, the maximum amount for computing the credit is $2,500 for a single person 65 or older and $3,750 for a married couple filing a joint return.

The maximum amount must be reduced by a tax-exempt retirement income, such as social security. The maximum amount must also be reduced by $1 for each $2 for which the taxpayer's adjusted gross income exceeds the following levels: $7,500 for single taxpayers; $10,000 for married couples filing a joint return.

I know that time is limited, Mr. Chairman. I would just summarize by saying this bill raises the maximum base figure to $3,000 per individual, $4,500 for couples filing jointly, and also it would index the the maximum base figure to reflect changes in the cost of living we have each year. That would obviate the necessity for us relegislating periodically to adjust for these changes. The bill also eliminates the phaseout figure altogether.

We believe that with these changes that we will be assuring protection to 4 million retired people who are for the most part, living without any social security benefits. We are giving them a break that they are certainly entitled to.

Senator BYRD. Thank you, Senator Hathaway, and your complete statement will be published in the record.

Senator HATHAWAY. Thank you very much, Mr. Chairman.

Senator BYRD. Senator Curtis?

Senator CURTIS. I have no questions.

Senator BYRD. May I ask, does Treasury have a position on this?

Mr. SAMUELS. Yes; we do, Senator. I believe—are there other witnesses on this bill as well?

Senator BYRD. There are other witnesses, so that being the case, the Chair will call on you later.

Mr. SAMUELS. Fine.

Senator HATHAWAY. You do not want to say it while I am here?

Mr. SAMUELS. We would prefer to wait for the other witnesses to testify.

Senator BYRD. Maybe we can get Senator Hathaway back.

Senator HATHAWAY. The cost of this is modest. It is only $500 million, Mr. Chairman, and it is worthwhile.

Senator BYRD. Thank you, Senator.

[The prepared statement of Senator Hathaway follows:]

STATEMENT OF SENATOR WILLIAM D. HATHAWAY

TAX CREDIT FOR THE ELDERLY (S. 2128)

Mr. Chairman, I appreciate the opportunity to testify on S. 2128, a bill to revise the tax credit for the elderly which I am pleased to cosponsor with Senator Inouye and several other distinguished colleagues. I am also grateful to this committee for its active consideration of numerous tax issues prior to the committee's action on major tax legislation this Congress.

I am deeply concerned about the economic security of this Nation's senior citizens. It is these men and women who have created our great country. It is they who have brought up a new generation to carry on that heritage of action and compassion. And it is our generation's obligation to secure their financial security in old age.

We have enacted numerous laws to assist our senior citizens. I have actively supported them. Among these programs are special tax provisions and the comprehensive social security system.

Under current law social security income is tax exempt. As a matter of legislative concern, we declared that the ability of elderly persons to meet basic medical and economic needs is of such social significance as to warrant this tax exemption.

However, the ability of nonrecipients of social security to meet these basic needs is no less important. To assure equality, Congress enacted a retirement credit for the elderly.

Presently, an individual at least 65 years of age is allowed a tax credit of 15 percent of an initial maximum amount (depending on the taxpayer's filing status) less certain reductions. The maximum amount for credit computation is not limited to retirement income. All types of taxable income are eligible for the credit: including retirement income, personal service, and investment income. The maximum amount for computing the credit is $2,500 for a single taxpayer, 65 or older and $3,750 for a married couple filing a joint return where both are 65 or older. The maximum amount must be reduced by taxexempt retirement income, such as social security. The maximum amount must also be reduced or $1 for each $2 by which the taxpayer's adjusted gross income exceeds the following levels: $7,500 for single taxpayers and $10,000 for married couples filing a joint return.

In other words, for persons 65 and older only those with adjusted gross incomes under $7,500 and no social security income are eligible for the full $375 credit. (15% of $2,500). Those persons with modest incomes ($7,500–$12,500) receive little or no credit, while those with incomes above $12,500 receive nothing. Of course, the maximum base figure is reduced by any social security income (or railroad retirement income) up to $2,500, at which point the individual's credit is completely eliminated. ($350 for couples filing jointly),

A 15 percent credit is also applicable to the retirement income of individuals under age 65 who are receiving benefits under a public retirement system.

These programs have contributed substantially to the economic security of our senior citizens. However, even today, about one-quarter of the elderly are either poor or "near poor"—that is, their incomes are less than 125 percent of the poverty line. For minority elderly, and women living alone, escape from poverty has been the most difficult.

S. 2128 will help to correct some of the deficiencies in the present credit for the elderly. It will extend significant tax assistance to many of the middle income senior citizens and it can contribute benefits to the low income elderly.

Specifically, it will:

1. raise the maximum base figure to $3000 for individuals and $4500 for couples filing jointly.
2. index the maximum base figure to reflect changes in the cost of living each year, and
3. eliminate the phase-out figures on the adjusted gross income of persons 65 and older.

What will be the effect of these changes?

First, the adjusted gross income phase-out feature of the credit discriminates against middle income taxpayers who rely on taxable retirement income. Elimination of the phase-out will more fairly equalize the tax treatment of those receiving tax-exempt social security benefits and those receiving taxable retirement income.

Second, the increase in the initial maximum amounts to which the credit is applied and the future cost-of-living adjustments to these amounts reflect the enormous impact that inflation has on retirement income. Retired persons are hurt by inflation more than other people. They have reduced income with little opportunity to save for the future. Increases in the cost of food, medical care, housing, transportation and energy place a severe burden on them.

Third, the elimination of the phase-out rule would remove what is, in essence, a penalty against savings and investment income, and active employment earnings by persons age 65 and older. Since the phase-out rule is based on an individual's adjusted gross income, limiting income from these other sources often pushes an otherwise qualified individual above the phase-out level causing him to lose all or part of the credit.

Fourth, the elimination of the adjusted gross income limitation would simplify the preparation of tax returns by the elderly.

Modifications may have to be made in this bill to assure its enactment this year; and I believe that tax relief for the elderly of America is imperative.

I do believe that S. 2128 is a fundamentally important reform to fulfill our promises to the nation's senior citizens.

We must never forget that their problems are our problems.

Last week HEW Secretary Califano spoke to the Senate Select Committee on Aging. He said:

"If we are spending more on behalf of older Americans, that is only as it should be. It is one mark of the respect in which society holds the older generation. Nor is the effort we make on behalf of the elderly unrelated to our own lives. The taxes that younger workers pay on what they earn today not only assures their own future, they make possible a better present for all generations. With medicare paying for the medical needs of elderly parents, the earnings of the young can be used for education or the down payment on a home. * * * The economic choices made by any one generation affect all."

We have made a commitment to the income security of the nation's senior citizens. They have given their earning lives to assure a better world for all of us. In their hours of retirement and reflection we should assure their financial security. We should do no less than enact S. 2128.

Senator BYRD. Next will be a group of witnesses, a panel of four: Mr. Richard C. Farrer, National Association of Realtors; Mr. Neil H. Offen, Direct Selling Association; Mr. Francis O. McDermott, representing the National Association of Independent Insurers; and Mr. Jerome B. Libin, representing Kansas Farm Bureau Insurance Cos.

Each will be discussing and supporting S. 3007 and S. 3037 and when this panel concludes, the Chair will ask the Treasury Department to give its view.

Fifteen minutes has been allotted to the panel.

STATEMENT OF RICHARD C. FARRER, CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL ASSOCIATION OF REALTORS

Mr. FARRER. Mr. Chairman and members of the committee, my name is Richard C. Farrer. I am a realtor from Castro Valley, Calif., and I am, at present, the chairman of the legislative committee of the National Association of Realtors.

Accompanying me today are Gil Thurm, our association's staff legislative counsel and Donald Osteen of the firm of Arent, Fox, Kintner, Plotkin & Kahn, our special tax counsel.

We welcome this opportunity to express the enthusiastic support of the National Association of Realtors and its 600,000 members for S. 3007, introduced by Senator Dole and cosponsored by 12 other Senators; S. 3037, introduced by Senators DeConcini and Haskell and cosponsored by four other Senators; and for H.R. 12427, introduced by Congressman Panetta and some 60 cosponsors.

The prompt enactment of such legislation is essential to provide timely relief to taxpayers from retroactive charges in the law and to prevent the IRS from usurping the right of Congress to set the standards defining independent contractor status.

Since 1951, more than 90 percent of the real estate salespeople—today, in excess of 1,200,000—have been recognized to be self-employed and have been taxed as such. Within the last 3 years the IRS has unfairly attacked real estate brokers with claims for back taxes on the erroneous theory that their salespeople are employees and not self-employed.

The IRS is presently ignoring the request of conferees on the Tax Reform Act of 1976 not to change its position regarding independent contractor status. As a result, taxpayers are being faced with financially ruinous retroactive tax assessments.

These huge proposed assessments are generally imposed against small businesses and have been for amounts which are more than the net value of the business. For example, recently a broker had a proposed assessment of $850,000 while his net book value was $400,000.

Such an assessment can drive a business into bankruptcy even if the IRS claim is without merit because of the inability to obtain credit with such a huge contingent liability outstanding. These huge assessments have a chilling effect and are designed to pressure taxpayers into treating their salespersons as employees.

In fact, we have heard of situations in which the IRS agents have indicated that ruinous backtax assessments could be dropped if the taxpayer agrees to treat his workers as employees in the future.

Congress may wish to undertake long and careful deliberations regarding future standards for independent contractor status. In the meantime, the prompt enactment of S. 3007, S. 3037, and H.R. 12427 is urgently needed to provide an interim respite from unjustified IRS attacks.

None of these bills would prevent the IRS from auditing genuine abuse situations. S. 3037 would override two specified IRS rulings which changed guidelines of nearly 30 years' standing.

S. 3007 and H.R. 12427 would prohibit the IRS from continuing to apply any changed position which is inconsistent with a position in effect on December 31, 1975.

Because of the short time left in this session of Congress, we urge this subcommittee to act quickly on this vital legislation.

Thank you for the opportunity to present our views. We will be pleased to respond to any questions the committee may have.

Senator BYRD. At this point, Mr. Farrer, I would like to ask this question.

The Treasury Department announced this morning in its summary positions on the bills set for hearings this morning that in connection with S. 3037 that Revenue Ruling 76–136 and 76–137 will be revoked and Treasury mimeograph 6566 will apply for all periods prior to January 1, 1979.

In view of this change in position, is legislation necessary at this point?

Mr. FARRER. Well, this would solve certainly, Senator, our immediate problem, because both of those rulings have happened since December 31, 1975. However, again, there is still ambiguity between the long-established industry practices and the manner in which the Internal Revenue Service's agents approach the audit of a real estate brokerage firm's independent contractor relationships.

Senator BYRD. You may proceed.

Mr. OFFEN. Thank you.

STATEMENT OF NEIL H. OFFEN, PRESIDENT, DIRECT SELLING ASSOCIATION

Mr. OFFEN. My name is Neil H. Offen and I am president of the Direct Selling Association—DSA, for short.

With your permission, I will summarize our testimony which has been submitted for the record.

DSA is the national trade association for the leading manufacturers, distributors, and retailers for products meant to be sold primarily in the home. Each year, 4 million individuals sell consumer products via our method of marketing. Of these, 80 percent are women, 12 percent are minority group members, 10 percent are disabled individuals, and over 100,000 are 65 years of age or more.

Direct selling offers income opportunities for all regardless of race, age, sex, marital status, educational background, financial, or physical condition, or any other artificial barrier to earning money often found in our society. According to a Lou Harris study, 8 percent of the homes in America will have someone in them selling in our industry each year.

Harris also found that the most important aspect in the business life of a direct salesperson was not the money they made, but rather their independence—being their own boss, working their own hours in their own way. Their sales volume for 1977 is estimated at $7.5 billion.

Our organization strongly supports the retention of the common law test which has worked well for generations and provides enough flexibility to assure diversity in the marketplace. Such diversity, especially in the promotion of individual initiative and entrepreneurship, contributes greatly to our national strength and should be fostered at every opportunity.

Our companies have been treating salespeople as independent contractors for well over 100 years and have successfully defended this status in court as recently as last year before the full Court of Claims.

However, due to recent IRS attempts to undermine the common law test, bills such as S. 3007 have been introduced.

DSA supports the concept behind this bill and salutes Senator Dole for taking a leadership position in it, and that concept is to stop IRS harrassment of independent contractors and companies associated with them.

We believe IRS is seeking to make as many independent contractors into employees as they possibly can. Such attempts are not within their responsibilities or duties, and have brought about catastrophic results for numerous taxpayers.

Unfortunately, we do not believe that S. 3007 is comprehensive enough. While it may help one or two industries, it very well might leave others in the same position existing prior to its passage—speciiicially, we do not believe tying the legislation to a December 31, 1975, date is sufficient, and accordingly submit for your consideration H.R. 13313, introduced by Congressman Panetta, which contains the provisions of S. 3007 and adds two sections.

These sections state that an individual shall not be treated as an employee if the taxpayer, in good faith, consistently treated the person as an independent contractor. The act would remain in effect until it was specifically repealed by the Congress.

DSA urges the amendment of S. 3007 to reflect this language.

DSA also supports legislative adoption of the procedural recommendations found in the GAO's report on this subject to the Joint Committee on Taxation. We also oppose any attempts to merely suspend audits while Congress studies this issue since a mere suspension will not help taxpayers facing huge and continuing assessments.

According to our economic consultant, Robert R. Nathan, the loss of the independent contractors status in our industry alone would result in cost increases in excess of $500 million per year. More significantly, it would result in a loss of at least two-thirds of the income opportunities direct selling provides.

I calculate that to be a loss to the work force of over 2,650,000 independent contractors. Your help in protecting these persons' incomes and our corporations' viability is needed.

We are confident that Congress will respond favorably to this need. We will miss particularly Senator Curtis' presence next Congress since he has been fighting the good fight in regard to this issue for 30 years, and the Nation owes him a debt of gratitude for his efforts.

Thank you very much.

Senator BYRD. Sir, I would like to second and agree 100 percent with that last statement.

Who is the next witness?

Mr. McDERMOTT. I am, Mr. Chairman.

STATEMENT OF FRANCIS O. McDERMOTT, PARTNER, HOPKINS, SUTTER, MULROY, DAVIS, & CROMARTIE ON BEHALF OF THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

Mr. McDERMOTT. Mr. Chairman and members of the subcommittee, Francis McDermott is my name. I am an attorney here in Washington, D.C., in private practice and appear on behalf of my client, the National Association of Independent Insurers.

This is a voluntary association of insurers. It has 400 members and virtually every State in the Union is represented in that membership. We are here to applaud Senator Dole and others who have taken a forefront position in trying to resolve this particular type of problem that we brought to the committee's attention in 1976 when it considered the plight of the shrimp boat and lobstermen. Hopefully we had obtained some relief from the conferee's on the Tax Reform Act in their directions to the Internal Revenue Service.

We have, however, been stymied and frustrated in attempts in trying to implement what we considered clear policy with the IRS on an adequate, equitable basis particularly for our member companies.

I would like to defer to Jerry Libin, who is an attorney with the firm of Sutherland, Asbil & Brennan, who represent many of our member companies, which have been virtually, and, I think, arbitrarily, harassed by the Internal Revenue Service with their attempts to reverse 30 years of revenue rulings which we have had and which the IRS has not, in a published ruling told us that the prior rulings were reversed.

Mr. Libin?

STATEMENT OF JEROME B. LIBIN, KANSAS FARM BUREAU AND OTHER INSURANCE COMPANIES

Mr. LIBIN. Mr. Chairman, I am here today on behalf of insurance companies located in the States of Kansas, Nebraska, Mississippi, Kentucky, and Indiana. Each of the companies I represent has been adversely affected by the position of the Internal Revenue Service relating to the status of their insurance agents as independent contractors rather than employees.

In the case of the Kansas companies, the audit of their insurance agents was begun on October 8, 1976, 3 weeks after Congress in the conference report of the 1976 Tax Reform Act asked the Internal Revenue Service not to adopt any new positions in connection with this question.

In the case of the Nebraska companies I represent, while the audit was begun prior to the conference report, it went back to the year 1969. No attempt to suspend the case was made after the conference report. Assessment was finally made in 1977. The companies had no choice but to pay some of the tax assessed and file a suit for refund in the Court of Claims, which they did in February of this year. In other words, they have been pushed all the way to litigation, notwithstanding the direction in the conference report of the 1976 act.

My prepared statement describes the situation with respect to the other companies.

Now, it is imperative, as I think Senator Curtis has recognized earlier this morning, that some legislative action be taken, because the Service has not paid any attention to the directions contained in the conference report.

Senator Dole's bill, S. 3007, deals with the problem. However as has been stated, it deals with it by adopting a cutoff date of January 1, 1976, for audit positions. That is simply too late to do any good, because many of these audit positions were adopted prior to 1976 and, as I mentioned, in some cases go quite far back. Yet they were the very reason why Congress took the action it did in the conference report.

Therefore, we recommend a date of January 1, 1970, as the proper date for freezing the audit position of the Internal Revenue Service.

Now, I am absolutely stupefied by what Senator Byrd indicated is the position of the Internal Revenue Service with respect to the real estate industry as of this morning. They have revoked published rulings issued in 1976 and announced that, with respect to that industry, they will adhere to their old position until 1979.

What about all of the other industries that have been hit by a change of position by the Internal Revenue Service during this period? It seems to me that something has to be done on a broad brush, across-the-board basis, and the time to do it is now.

Thank you very much.

Senator BYRD. Next witness?

Does that complete the testimony?

Mr. McDERMOTT. Mr. Chairman, with regard to the Dole proposal, S. 3007, we feel that there are two basic fundamental changes that we would like adopted: the one Mr. Libin touched which deals with changing the date to 1970, and particularly now with the announcement, of the Treasury Department today even makes it more imperative.

We would also like to have it broadened and incorporate, perhaps the method that Congressman Panetta has put forth in his bill; namely, a good faith test. A test that if an individual or corporation has consistently filed returns and has consistently treated his personnel in those returns over a period of years, as independent contractors such action would demonstrate good faith, and further, that if he has rulings in his favor, he should not, in any way, shape or form, have a changed IRS position imposed on him after, say, 5 or 10 years of feeling as though he was in the right.

I think the lumber people from Vermont could very well be that type of case, and this would certainly insure fair treatment in this regard.

Senator BYRD. Thank you.

Senator Curtis?

Senator CURTIS. Mr. Libin, you anticipated my question, and that was would the announcement as to the change in these regulations take care of this problem across the board and you said that it would not.

Mr. LIBIN. That is my understanding, that it would not.

Senator CURTIS. I would like to ask the lawyers on the panel before us if they would be willing to prepare some language for us, which, in the light of the entire problem, solve the problem at least temporarily in order to protect the interests of all people, until the Congress can resolve the matter permanently.

You have made some suggestions here. Would you, within a reasonable time, submit some language?

Mr. LIBIN. We would be delighted to do that. I am sure can have something for you very promptly, Senator.

Senator CURTIS. Mr. Chairman, I would like to have incorporated into the record at this time the pertinent paragraph from the conference report of the Tax Reform Act of 1976. The paragraph in question is paragraph 2 on page 489. I will not take time to read it, but that was a reaffirmation by the full conference on the position taken by the Finance Committee and it sets forth this problem.

Senator BYRD. Without objection, so ordered.

[The material to be furnished follows:]

Because the status of individuals as independent contractors or employees for Federal tax purposes presents an increasingly important problem of tax administration, the conferees agreed to join in the request of the Senate Finance Committee (S. Rept. 94–938, p. 604) that the staff of the Joint Committee on Taxation make a general study of this area. The conferees also join in urging the Internal Revenue Service not to apply any changed position or any newly stated position which is inconsistent with a prior general audit position in this general subject area to past, as opposed to future taxable years until the requested staff has been completed. Thus, the conferees agree with the statements on this aspect of the subject in the Finance Committee's Report (S. Rept. 94–938, p. 604), as amplified by the Chairman and ranking member of the Finance Committee on July 26, 1976, during consideration of H.R. 10612 by the Senate.

Senator CURTIS. Since we have covered this matter with other witnesses, I will not have any questions, but we do express our gratitude for the panel and their contribution to this important problem.

Senator BYRD. Senator Dole?

Senator DOLE. I would like to insert into the record a statement.

Senator BYRD. Yes; your statement will be published in full.

Senator DOLE. It is a statement I have prepared on S. 3007 and a number of other bills I have introduced that are the subject of the hearings on today.

[The material to be furnished follows:]

STATEMENT OF SENATOR BOB DOLE

Mr. Chairman, I appreciate the chairman calling these hearings to address a number of tax initiatives. Many of the issues which the committee will hear today are very important.

Mr. Chairman, two of the bills which are slated for consideration—S. 2392, a bill relating to small business incorporations and S. 3125, a bill regarding involuntary conversion of special use valuation property have benefited from advance consultation with the Treasury Department.

A meeting between the Finance Committee staff, my staff, and Treasury officials will hopefully smooth the way for passage of this technical, but needed legislation.

Dole Proposals

Mr. Chairman, the subcommittee will be addressing seven proposals which I have initiated or support as a cosponsor. The most controversial involves S. 3007 which I believe is first on the schedule.

S. 3007—INDEPENDENT CONTRACTORS

Mr. Chairman, the classification of persons as employees or independent contractors for Federal tax purposes has for many years been determined by the common law. Because of an increase in Internal Revenue Service attacks on these long established rules, the Tax Reform Act of 1976 directed that a study on the subject should be conducted by the staff of the Joint Committee on Taxation. That study is still in progress. However, since that time Internal Revenue Service has been changing—by fiat—the status of the law.

The Internal Revenue Service frequently determines that persons have been misclassified as self-employed and should, instead, be considered employees. Such determinations by the Internal Revenue Service are generally retroactive. This determination can be devastating upon a small or large businessman. Employers can be retroactively assessed employment tax for three tax years. Double taxation can occur when the employer and employee pay income and social security tax on the same income. Self-employment retirement plans established by individual taxpayers can be declared invalid with all prior tax contributions and income earned becoming taxable for the current year.

The hearing today will address my proposal, S. 3007. I know there are many groups interested in this issue. I look forward to hearing their comments.

S. 2462—LIRA

The hearing will also address S. 2462, my proposal for establishing limited individual retirement accounts.

In many cases, the amount that is contributed to a pension plan on behalf or for a worker is limited to a percentage of the worker's salary or by the plan itself. Thus, many workers do not have an opportunity to have the $1,500 allowed by an IRA to be put aside for retirement. This legislation would allow active participants in plans of qualified deferred compensation to establish a limited individual retirement account. This proposal, if enacted, will open up increased retirement benefits for millions of Americans.

S. 3288—PENSION PLAN DEDUCTION

The enactment of the Employee Retirement Income Security Act of 1974 has contributed to the instability of many pension plans. I think that every American should have the opportunity to provide for his retirement. However, because of inflation and burdensome Government regulation, it is increasingly apparent that many Americans will not have adequate benefits to provide for their later years.

Qualified plan deduction

My proposal, which I introduced on July 13, grants an employee, who is an active participant in a qualified pension plan, a deduction to the extent of the contribution to the plan, or to an IRA or in part to a qualified plan and in part to an IRA. The deduction allowed under my proposal is limited to the lesser of 10 percent compensation or $1,000. The deduction would be allowed from gross to adjusted gross income. A deduction will be allowed for either mandatory or voluntary contributions. If the plan does not permit employee contributions, the employee may contribute within the limits, to an individual retirement account.

S. 3125—SPECIAL USE VALUATION

The Tax Reform Act of 1976 provided that certain property used in farming or a closely held business could be valued for estate tax purposes according to its current use rather than its best use. Special use valuation provides significant reductions in estate taxes for those estates which have a large portion of the value tied up in these nonliquid assets.

However, in the past several years, farmers and businessmen have been inflicted with harsh tax results under the special use valuation rules when there is an involuntary conversion.

Involuntary conversion

Under the current law, there is a recapture rule which mitigates the tax benefits if the divisees dispose of the property or change its use within 15 years of the death of the decedent. The recapture insures that the property will continue to be used in a manner consistent with the special use valuation.

Mr. Chairman, an involuntary conversion during the recapture period can produce an unwarranted tax result. S. 3125 proposes that where an involuntary conversion of qualified real property takes place, no recapture of the estate tax occur if like property of equal value and use replaces the involuntary converted property.

If property of lesser value replaces the involuntary converted property there would be a proportionate recapture.

I believe my bill is noncontroversial and is needed because of an oversight in the original enactment of this law.

S. 233—SMALL BUSINESS INCORPORATION

This bill is designed to reflect recent judicial interpretation of § 357 of the Internal Revenue Code. I believe that it is needed to prevent unwarranted tax consequences to the small business.

Current law

Under sections 351 and 357 of the Internal Revenue Code, a taxpayer generally will not recognize gain or loss upon the transfer of property and liabilities to a controlled corporation in exchange for stock or security of that corporation.

However, section 357(c) provides that gain will be recognized to the extent that the aggregate amount of liabilities transferred to the corporation exceeds the aggregate adjusted basis of the properties transferred.

Unexpected results

A problem may arise when the taxpayer transfers existing trade receivables and payables to a new corporation. A cash basis taxpayer generally has no basis for his accounts receivables, so that if payables of the cash basis taxpayer constitute "liabilities" for the purpose of section 357(c), an excess of liabilities over basis usually will generate an unexpected taxable gain.

I believe that section 357(c) was designed to prevent taxpayers from realizing an economic benefit, without tax, through the simple expedience of transferring of low basis, appreciated property and associated liabilities to a controlled corporation. However, the application of section 357(c) to the cash basis taxpayer can result in harsh, unexpected tax consequences where no economic gain or benefit has in fact, been realized.

S. 2393 closely follows a recent tax court decision of Donald D. Focht, 68 T.C. 223 (1977). Basically, the thrust of the proposal would define the term "liabilities"—for purposes of both sections 357(c) and 358(d)—as not including any obligation which would have entitled the transferor to a deduction if paid by him.

This measure is to help small businesses around the country. Too many times, an unsuspecting businessman has inadvertently run into the trap of gain recognition. It is time that the Congress move to clarify the law.

S. 2128—TAX CREDIT FOR THE ELDERLY

The enactment of the tax credit for the elderly represents a milestone in legislation affecting taxpayers age 65 and older. Passage of that legislation in 1976 was a commendable attempt to provide some form of tax relief for elderly persons with little or no social security.

Unfortunately, the tax relief granted under the ACE has proven to be inadequate and the availability of credit too restricted to benefit the thousands of older Americans in critical need of its assistance.

Under present law the TCE is available to all persons 65 and older who (1) Receive less than $2,500/$3,750 in social security payments or railroad retirement, and (2) whose incomes fall below the adjusted gross income phaseout levels. This includes public retirees who receive no social security. Public retirees under age 65 also qualify for the credit provided they meet an earnings test and do not receive social security payments beyond the maximum base level.

Under S. 2128 all limitations relating to an individual's adjusted gross income will be eliminated. This means that all persons 65 and older will be eligible for the credit as long as their social security and railroad retirement payment does not exceed the maximum base figure.

The bill also provides for indexing the income base. This provision is similar to a provision in my bill, S. 2738, the Tax Indexation Act of 1978.

I believe this legislation is a positive step for older Americans.

S. 1674—TIP REPORTING

This bill addresses an important problem of tip reporting. The bill is similar to a provision adopted by the Finance Committee in 1976 sponsored by Senator Paul Fannin of Arizona. This bill overturns the effect of Revenue Ruling 76-231 requiring employers to report all charged tips, whether or not they were reported to the employer by the employee.

I believe the ruling is in conflict with current tax law and the intent of Congress. The bill will eliminate the extensive record-keeping requirement of reporting burdens proposed by the IRS.

Mr. Chairman, I want to thank you for scheduling these hearings. I hope the committee will favorably consider the testimony given today.

Senator DOLE. I want to thank the chairman for scheduling the hearings. I know that time is at a premium. I appreciate it very much. It seems to me that we have had some good suggestions from this panel. Certainly we can try to help. The 1976 cutoff date would not do much for you. But we are talking about a problem here that not only affects just a few people. It is a problem that affects 6 to 8 million Americans. It is one that may have been partly satisfied with the revocation of a couple of revenue rulings, but I do not think that really addresses the total problem.

The revocation might satisfy the Realtors in some cases, but I do not think totally. Is that correct?

Mr. FARRER. That is correct, Senator.

Senator DOLE. I have not seen this revocation. There has been a proposal, Mr. Farrer of freezing assessments and extending the statute of limitations while Congress studies the independent contractor issue. That would put all taxpayers in limbo. You would never know whether there is going to be a big assessment down the road or not.

Does that suggestion appear to be an alternative that would be a satisfactory approach to the problem?

Mr. FARRER. No, Senator. To have an assessment as a part of your financial statement would not be very complimentary to your business. And it is certain that in the case of any financial or other needs you might have, such as the extension of credit, the banks would not look favorably at such an assessment that then would remain on your financial statement during the entire period that Congress studies the independent contractor issue.

In addition, as a taxpayer, I would have to carry the burden related to accounting costs and also attorney fees, because I am sure from time to time that there would be some responses necessary to the Internal Revenue Service and for other reasons arising out of the assessments which are held in "limbo."

And so the "freeze," to me, would not be acceptable.

Senator DOLE. Have these actually been some rather large retroactive assessments? If so, I wonder if you might mention one or two, and then furnish others for the record.

Mr. FARRER. We would be most pleased to. We have, specifically, a company which has an assessment of $720,000 where its net worth is only $350,000. I also made reference in my direct testimony to an $825,000 assessment where the company's net worth is only $400,000.

Of course, this comes about because the Service then in effect, bills the broker for all the withholding tax, the FICA and the unemployment tax for all the years which the audit has under question. That is how you build up these tremendous amounts of money, when in truth the independent contractor had probably paid all of those taxes already to the Government.

So, in effect, then, you create a double billing or, in effect, a double taxation.

Mr. Offen. Mr. Chairman, Senator Dole, if I might add, the Service will not cooperate with a company that has been judged to be an employer as opposed to having an independent contractor relationship in recovering income taxes paid by the independent contractors, or the putative independent contractors who are now being treated as employees, and consequently they are having the double taxation situation which has been alluded to.

In our industry, we are facing—some of our companies were faced with—assessments that consisted of more than their net worth but were in substantially larger amounts than were mentioned by the prior speaker. Specifically, in the *Cleanway* case, we were talking about $13 million, and in the *Beeline* case, which has just been settled by the Service to the satisfaction and complete victory as we understand it, of Beeline Fashions, for $45 million.

So it is not just the individual small business that is being affected, which most of our people are, but also larger, medium, and larger sized corporations as well.

Furthermore, just mere suspension of the audit situation with the statute of limitations not running would also affect, perhaps, the SEC requirements of publicly held corporations and an impact on the stock market.

Mr. McDermott. Senator, if I may, we also have alluded to examples of IRS audit policy in Mr. Libin's testimony. We would also like to submit further examples to make the record more complete.

Senator Dole. I think it might be helpful. There is always a question that somebody has dreamed up some horror story that has stimulated Congress to do something.

[The following was subsequently supplied for the record:]

Specific Examples of Adverse Impact of Current IRS Practices Relating to Independent Contractors

1. *Barber.*—Nickey Moss, co-owner of a barbershop in Decatur, Georgia, has been assessed $25,000, based on a finding that barbers who leased chairs in his shop in 1972, 1973, and 1974 were employees and not independent contractors. The leases used were form independent contractor leases that had previously been approved by the IRS District Director's Office in Atlanta. The IRS placed liens on all of Moss's assets, including his home, which he has been trying to sell for a number of months but now cannot sell until the lien is satisfied.

2. *Logger.*—Reginald Dwyer, a logger in Vermont, has been assessed $18,500 by the IRS, which is approximately his net worth. Dwyer has now assumed the risk of working alone in the woods, rather than using contractors who may later be treated as employees by the IRS.

3. *Direct Selling.*—Wheatonware, a division of Wheaton Industries of New Jersey, was forced to go out of business rather than allow liability to accure while litigating a proposed assessment of several hundred thousand dollars. Termination of Wheatonware's operations resulted in the loss of approximately 2,500 income-earning opportunities.

4. *Home Improvement.*—Theodore Brownlee, a minority businessman in Atlanta, Georgia, had been a general contractor in home construction and renovation projects, since 1970. In 1977, a Revenue Agent proposed retroactive deficiencies and penalties with respect to carpenters and other subcontractors engaged by Brownlee during the period 1974–1976. Brownlee, who was already experiencing financial difficulties, faced adjustments of almost $10,000, an amount in excess of his annual income. He was forced to give up his own business and take a job as an employed construction worker.

5. *Insurance.*—On October 8, 1976, a few weeks *after* Congress adopted the Conference Report on the Tax Reform Act of 1976, the IRS *began an audit*

of the Kansas Farm Bureau insurance companies. On April 3, 1978, the companies received letters proposing assessments for the taxable years 1974–1976 of over $5.8 million.

6. *Real Estate.*—The IRS has proposed a financially ruinous assessment of $850,000 against one real estate broker, an amount over twice the size of his business's net book value.

7. *Real Estate.*—Another real estate broker had an assessment of $720,000 proposed against him even though the net worth of his business is only $350,000.

8. *Taxicab.*—White Top Cab Company, a small cab company in Warner Robins, Georgia, treated its taxicab drivers as independent contractors for more than 20 years without challenge. Those drivers have now been retroactively reclassified by the Atlanta District Director's Office as employees of the cab company, beginning with the year 1974. The amount at issue is $11,578, and the IRS has said it plans to make similar proposals for later years. The same District Office reviewed many similar cases involving much larger Atlanta taxicab companies in 1972 and agreed with their treatment of taxicab drivers as independent contractors.

9. *Insurance.*—The Indiana Farm Bureau insurance companies of Indianapolis are facing assessments for the years 1969–1970 and 1973–1975 totalling $6.9 million, a portion of which was proposed as recently as January 1978.

10. *Logger.*—Robert Beausoleil has received an assessment of $45,000 resulting from an IRS claim that some truckers who own their own trucks are his employees. In light of this action, King George Farms of Vermont has stopped selling logs, resulting in a layoff of its employees, and another contractor has sold his equipment and gone out of business.

11. *Gasoline Marketing.*—Pensacola Petroleum Company of Pensacola, Florida, treated its service station operators as independent contractors since beginning business in the 1960's. The IRS has now asserted that the station operators are employees of the marketing company, and, consequently, that they should have been covered by the company's qualified pension plan. As a result, the IRS has issued a letter disqualifying the plan and forfeiting the benefits it affords to regular company employees. The case is pending in the Tax Court. In addition, employment tax adjustments of $136,000 have been proposed for the years 1973 and 1974. The Company's after-tax income for those years was approximately $128,000.

12. *Insurance.*—In April, 1977, Mutual of Omaha Insurance Company and its affiliate United Benefit Life Insurance Company, were assessed a total of $1.4 million for the year 1969. The companies had no choice but to pay a portion of that assessment and institute a refund suit, which they did in the United States Court of Claims in February, 1978. More recently, the IRS completed its audit of the companies' employment tax returns for five subsequent years (1970–1974) and in June, 1978, proposed additional assessments of $10.6 million. The proposed assessment for the year 1971 is directly contrary to a *favorable IRS technical advice memorandum* issued with respect to the companies in November 1971.

13. *Trucking.*—Junior L. Franklin, a taxicab driver in Atlanta, Georgia, owned a single truck operated by a Tennessee resident under contract with a common carrier. Franklin was often forced to pay unloaders, whom he had never seen, to unload freight. Franklin was hospitalized once as a result of knife wounds incurred in a fight with loaders of a warehouse in Texas who objected to his unloading freight himself. The IRS has retroactively reclassified the loaders and unloaders as employees of Franklin, and an Appellate Conferee has advised his attorneys that assessment of tax deficiencies and penalties of over $9,000 will be made on September 1, 1978.

14. *Insurance.*—Colonial Life & Accident Insurance Company of Columbia, South Carolina, has received a letter proposing adjustments for the years 1973–1976 of approximately $3.4 million.

15. *Gasoline Marketing.*—In the case of one midewestern oil company, the IRS has proposed adjustments for the years 1968–1972 amounting to $50 million. The company has had to disclose this contingent liability in financial reports to its shareholders.

16. *Further Insurance Examples.*

(A) MFA MUTUAL INSURANCE COMPANY AND AFFILIATES

On September 27, 1976, attorneys for this company wrote to the IRS District Director in St. Louis, Missouri, with copies to Commissioner Alexander and other IRS officials, calling the attention to the Service to the pertinent legislative

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materials and requesting that processing of the MFA case be suspended pending competion of the study by the Joint Committee. By notices dated October 11, 1976 and October 18, 1976, the IRS impounded more than $900,000 in amounts owing to this company and applied the amounts against the asserted retroactive employment tax deficiencies. In seizing these amounts, the IRS allowed no credits or offsets for income or self-employment taxes paid by agents, although evidence of such payments was properly submitted to the IRS on forms 4669 on March 27, 1976. By a letter dated October 22, 1976, the St. Louis District Director informed counsel for this company that there was "no basis in current law" to suspend the processing of withholding tax deficiencies relating to the years 1968–71 and that the Service was accordingly 'not in a position" to "refrain from further collection actions." With respect to the retroactive assessment of employment taxes for the years 1972–74, the taxpayer was notified by a letter dated October 26, 1976 that its request for suspension of these cases pending a study by the staff of the Joint Committee had been discussed and that, "It is the consensus that action on these cases should not be suspended." This letter also informed the taxpayer that the Appellate Conferee would "assume," without a conference, that settlement of this case was possible and that the "years will be forwarded to the Kansas City Service Center for assessment."

(B) UNITED FARM BUREAU FAMILY LIFE INSURANCE COMPANY AND AFFILIATE

On August 12, 1976, counsel for the above companies asked the District Director of Internal Revenue in Indianapolis to request reconsideration of an adverse Technical Advice Memorandum issued by the National Office under date of May 26, 1976, in which the National Office declined to grant retroactive relief under § 7805(b) with respect to the employment tax status of commission insurance agents of said companies. The August 12 letter made specific reference to the colloquy which occurred between Chairman Long and Senator Curtis on the Senate floor on July 26, 1976.

Counsel was subsequently informed by the District Conferee in Indianapolis that the Conferee had been in telephone contact with the National Office of the Internal Revenue Service on two occassions regarding the request for reconsideration, and had been told that the National Office intended to issue a general pronouncement on the question of retractivity in this area. Counsel was advised "not to be optimistic." (No pronouncement had yet been issued.)

In mid-September 1976, the District Conferee informed counsel that the District Director had decided not to request reconsideration of the adverse Technical Advice Memorandum. Counsel then called to the attention of the Conferee the pertinent statements in the Conference Report on the Tax Reform Act of 1976, which had been released on September 13, 1976. The Conference, who had just returned from a vacation, was not familiar with the Conference Report statements, and agreed to contact the National Office again for direction.

Shortly thereafter, the Conferee informed counsel that the National Office did not consider the Conference Report to be a sufficient basis for suspending handling of the matter or for taking any further action at the National Office level. The Conferee therefore requested an indication from counsel as to whether the matter would be taken to the Appellate Division, and was informed that it was counsel's desire to have the Appellate Division consider the case. A conference with the Appellate Division has not yet been scheduled.

(C) NORTH CAROLINA FARM BUREAU INSURANCE COMPANY

The attorney representing this company called the pertinent legislative materials to the attention of the Appellate Conferee. Several weeks ago the Conferee informed counsel that assessment would be made in the near future. The Appellate Conferee stated that he did not have authority to delay assessment on the basis of the language contained in the Report of the Conference Committee on the Tax Reform Act. The Conferee indicated that assessment could be expected on or about the first of December.

(D) FARM BUREAU MUTUAL INSURANCE COMPANY OF IOWA AND PREFERRED RISK MUTUAL INSURANCE COMPANY

On August 31, 1976, a conference was held with respect to the Preferred Risk Mutual case in the Appellate Division of the Regional Commissioner's Office. Counsel for the company asked the Conferee to consider the language in the

Senate Finance Committee's Report. In a subsequent telephone conversation, counsel called the attention of the Appellate Conferee to the pertinent language in the Report of the Conference Committee. The Appellate Conferee took this information into consideration and several weeks later informed the company that he was not in a position to delay processing of the case on the basis of the legislative history which had been called to his attention. The Conferee indicated that an assessment would be issued with respect to this case. Assessments had previously been entered with respect to Farm Bureau Mutual Insurance Company of Iowa, which is represented by the same attorneys. In light of the position taken by the Appellate Conferee, this case continues to be processed by the Collection Division in Des Moines, Iowa.

(E) AMERICAN FAMILY MUTUAL INSURANCE CO., AMERICAN FAMILY LIFE INSURANCE CO., AMERICAN FAMILY STANDARD INSURANCE CO., AND AMERICAN FAMILY FINANCIAL SERVICES, INC.

By letters dated August 12, 1976, September 3, 1976, September 29, 1976 and October 8, 1976 pertinent legislative materials were called to the attention of IRS personnel processing this case. The District Director responded by a letter dated October 14, 1976 indicating that the Service would continue to process the case since it had "no knowledge of any announcement or directives to be issued by our National Office pursuant to the request of the Senate Finance Committee and the Conference Committee." The letter also stated that no further extension of time within which to file a written protest could be granted "unless a definite announcement or directive is forthcoming in the interim."

Senator DOLE. In your statement, Mr. Farrer, you refer to the problem of withholding of taxes on gross income rather than on net income. I wonder if you might expand on this in terms of real estate salespeople?

Mr. FARRER. Thank you, Senator. Yes; in terms of the gross income, this is the amount of the commission that the independent contractor actually receives at the closing of the sale. But his net income is reduced by some charges and expenses.

For example, he pays his own dues to a local Board of Realtors. He also makes a contribution to a multiple listing service. He also incurred expenses dirctly involved in that sale. Possibly some business lunches; certainly travel by automobile. And so he has expenses which the IRS will allow as they relate to his being an independent contractor.

So, the gross is the amount that he receives, while the net is the amount that he actually has to pay income taxes on. If he comes under the social security tax as being self-employed, he then pays his social security taxes based on the net amount.

Mr. OFFEN. Senator, if I might, I would like to add something, too, to that. We have about 2 million people on commissions and therefore we face the same situation that was just mentioned, but we also have about 2 million people who are on a wholesale-retail relationship—in other words, they purchase the product from our companies and then resell it to the consumer.

Those people would have nothing to base a withholding—our companies would have nothing to base withholding on, and Treasury has suggested that there just be some arbitrary percentage allocated to the wholesale price, which is not withholding, but some sort of new excise tax concept.

Senator DOLE. I appreciate the testimony of the panel and those additional examples will be helpful. I agree with Senator Curtis. We want to put together something that will cover the inequities.

We will be happy to work out appropriate and responsible language. These suggestions you have will be appreciated.

Mr. McDermott. Senator, on that point it is a very difficult problem and is exemplified by a provision in the Tax Reform Act, providing relief from IRS employment tax audit action that was to be given to the shrimp boat and lobster industry. As you recall, that had a retroactive date of 1971. Now the Treasury has recommended a 1954 date—with which we are in complete accord, but I think that merely highlights that this problem is a very difficult one, indeed.

Senator Byrd. Thank you, Senator Dole.

Senator Laxalt?

Senator Laxalt. No questions.

[The prepared statements of the preceding panel follow. Oral testimony continues on p. 117.]

STATEMENT OF RICHARD C. FARBER, CHAIRMAN OF THE REALTORS LEGISLATIVE COMMITTEE ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS

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SUMMARY

The National Association of Realtors heartily endorses S. 3007, S. 3037 and H.R. 12427 providing a necessary interim respite to independent entrepreneurs, while Congress studies possible long-term standards regarding independent contractor status.

Since 1951, more than 90 percent of the real estate salespeople (today in excess of 1,200,000) have been taxed as self-employed persons. Within the last three years, the Internal Revenue Service has unfairly attacked real estate brokers with claims for back taxes on the erroneous theory that their salespeople were not self-employed but employees. This attack was inconsistent with long-established guidelines and not warranted by any new development.

The above bills would not stop all IRS audit activities. The IRS could continue to correct genuine abuse situations. S. 3037 would override two specified IRS rulings, Revenue Rulings 76–136 and 76–137, which changed guidelines of nearly 30 years standing regarding the classification of real estate salespeople as independent contractors. S. 3007 and H.R. 12427 are very similar and would prohibit the IRS from continuing to apply any changed position or newly stated position which is inconsistent with a general audit position, regulations or ruling in effect on December 31, 1975.

Small businesspeople are being faced with huge proposed assessments for back taxes. These taxpayers may be driven into bankruptcy even though they may ultimately prevail over the IRS.

While Congress studies long-term standards for independent contractor status, there will be many more small businesspeople faced with possible bankruptcy unless interim relief is provided now. S. 3007, S. 3037, and H.R. 12427 all provide this urgently needed short-term respite and deserve prompt enactment.

Mr. Chairman and Members of the Committee: My name is Richard C. Farrer. I am a Realtor from Castro Valley, California, and I am at present the Chairman of the Legislative Committee of the National Association of Realtors. Accompanying me today are Albert E. Abrahams, Staff Vice President for Government affairs, and Gil Thurm, Staff Legislative Counsel and Director of Tax Programs for the National Association of Realtors. We welcome and appreciate this opportunity to present the following statement on bills affecting the classification of individuals as employees or independent contractors for Federal tax purposes.

The National Association of Realtors is comprised of 50 state Associations, and more than 1,720 local boards of Realtors located in every State of the

Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is in excess of 600,000 persons actively engaged in sales, brokerage, management, counseling, and appraisal of residential, commercial, industrial, recreational, and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the United States concerned with all facets of the real estate industry.

INTRODUCTION

We are happy to appear here today to express the enthusiastic support of the National Association of Realtors for two Senate bills, S. 3007 introduced by Senator Robert Dole and cosponsored by Senators Carl T. Curtis, Orrin G. Hatch, Frank Church, John G. Tower, Richard G. Lugar, Pete V. Domenici, Mike Gravel, Thomas F. Eagleton, Harrison H. Schmitt, James A. McClure, Strom Thurmond, and S. I. Hayakawa, and S. 3037 introduced by Senators Dennis DeConcini and Floyd K. Haskell and cosponsored by Senators J. Bennett Johnston, Jr., Mike Gravel, Walter D. Huddleston, and Lloyd M. Bentsen. Similar legislation has been introduced in the House by Congressman Leon E. Panetta and some 60 cosponsors (H.R. 12427 and similar bills). The prompt enactment of such legislation is essential to provide timely relief to taxpayers from retroactive changes in the law and to prevent the Internal Revenue Service from usurping the right of Congress to set the standards defining employees and self-employed independent contractors.

The effect of these bills is to reverse certain recent changes in ruling and audit practices made by the IRS contrary to the expressed wishes of Congress. The conferees on the Tax Reform Act of 1976 recognized that the status of individuals as independent contractors or employees presented an increasingly important problem of tax administration and that a new legislative definition of such status might be appropriate. Therefore, the conferees requested the staff of the Joint Committee on Taxation to make a general study of this area. The conferees also instructed the Internal Revenue Service not to apply any changed position or any newly stated position which is inconsistent with a prior general audit position until the requested staff study was completed.

Since 1951, more than 90 percent of the real estate salespeople (today in excess of 1,200,000) have been recognized to be self-employed and have been taxed as such. Within the last three years, the Internal Revenue Service has unfairly attacked real estate brokers with claims for back taxes on the erroneous theory that their salespeople were employees and not self-employed independent contractors. This attack was unexpected, inconsistent with the industry's understanding of the long-established guidelines, and not warranted by any new development.

Congress has indicated its desire to study the subject of the tax treatment of employees and self-employed persons. The National Association of Realtors supports this study because of its commitment to maintaining the right of individuals to choose to do business as independent entrepreneurs. In this regard, our Association has submitted a statement to the Joint Committee on Taxation pursuant to the request of the Joint Committee for comments on this issue.

Because of the many industries and occupations which would be affected by any new legislation redefining the status of individuals as employees or independent contractors, Congress will likely undertake long and careful deliberation. On the House side, for example, a task force of members of the Ways and Means Committee has been established to study the issue. In the meantime, however, if no steps are taken by Congress to compel the Internal Revenue Service to comply with the directions of the conferees on the Tax Reform Act of 1976, the Service will likely continue its unjustified attacks on real estate salespeople and other independent contractors. Therefore, the swift enactment of S. 3007, S. 3037, H.R. 12427, or a similar bill incorporating the essential provisions of these bills is urgently needed to provide an interim respite from unjustified IRS attacks while Congress studies the matter.

It should be noted that none of these bills would stop all IRS audit activities. The IRS could continue to audit and to correct genuine abuse situations. S. 3037 would override two specified IRS rulings, Revenue Rulings 76–136 and 76–137, which changed guidelines of nearly 30 years standing regarding the classification of real estate salespeople as independent contractors. S. 3007 and H.R. 12427 are very similar and would provide further relief by prohibiting the IRS from continuing to apply any changed position or newly stated position which is inconsistent with a general audit position, regulation or ruling in effect on December 31, 1975.

Because of the short time left in this session of Congress, the National Association of Realtors urges this Subcommittee to act quickly on legislation to provide urgently needed relief to literally millions of small businesspeople who choose to be self-employed independent entrepreneurs.

BACKGROUND

For over 40 years, the central controversy in the employment tax area has been the question of whether particular workers or classes of workers should be treated as employees or as self-employed independent contractors. The distinction is important under existing law because employees and their employers are subject to tax under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) (Sections 3101 and 3301 of the Internal Revenue Code), whereas independent contractors are subject to tax on self-employment income (SECA) imposed by Section 1401 of the Code. Also, compensation paid to employees is subject to income tax withholding under Section 3402 of the Code, whereas independent contractors make quarterly income tax payments on their own behalf. Further, self-employed persons can establish Keogh retirement plans, whereas employees may not (although they may be able to establish Individual Retirement Accounts). Thus, reclassification of an independent contractor as an employee can cause a retirement plan to become invalid with all prior untaxed contributions and income earned thereon becoming taxable in the current year.

It is also important to note that income and social security taxes are withheld from an employee based on his gross compensation, whereas an independent contractor pays these taxes based on his net earnings after expenses. The distinction is very important to many independent contractors, such as real estate salespeople, who incur significant expenses in the pursuit of their livelihood. Reclassifying real estate salespeople as employees and thereby basing their taxes on gross earnings causes salespeople to pay unfairly high social security taxes and also causes problems regarding overwithholding of income taxes. The problem of overwithholding of income taxes arises, for example, in the case of a real estate salesperson with significant but fluctuating business expenses. While a taxpayer may claim additional personal exemptions on his employee withholding statement to reduce the amount withheld from his gross income, it may be difficult, if not impossible, for a real estate salesperson to estimate the amount of his future business expenses and thus the proper number of additional exemptions to claim.

One of the major reasons for the current attempt by the Internal Revenue Service to reclassify independent contractors as employees is to make its own administrative functions easier. Yet, the IRS is trying to make sweeping substantive changes in the law to ease these administrative duties. A prospective reclassification of independent contractors as employees would produce little if any additional revenue. (A retroactive reclassification may produce significantly more revenue due to the problem of double taxation discussed below.) Revenue is not greatly increased because an independent contractor pays, on his own behalf, income and social security taxes corresponding to those withheld and paid by an employer on behalf of his employees. (There may be some increase because of the difference between FICA and SECA taxes.) Revenue may, in fact, be decreased because reclassification as an employee may cost the marginal worker his livelihood due to increased tax, administrative, and bookkeeping costs to the alleged employer.

The Internal Revenue Service has claimed that the present lack of withholding of income taxes on payments to independent contractors causes underreporting of income on tax returns. However, the General Accounting Office (GAO), in its report to the Joint Committee on Taxation regarding the tax treatment of employees and self-employed persons (dated November 21, 1977), has determined that the IRS claims are exaggerated. Moreover, the General Accounting Office points out that the IRS has failed to consider other possible administrative approaches to any problem of underreporting.

The approach chosen by the Internal Revenue Service to solve its administrative problems has caused great misery to many taxpayers. Rather than seeking a prospective solution, the Service has applied new and highly stringent standards retroactively. It has attempted to reclassify independent contractors as employees for past as well as present years and has sought to assess back income, social security, and unemployment taxes. If the alleged employer had been given fair notice beforehand, he could have withheld income taxes and the employee's share of social security taxes from the worker's compensation. By attempting to change the rules retroactively, after the alleged employer had missed his chance to withhold, the IRS is seeking to impose a tax, often very large, on a person who would not otherwise have to bear the burden of paying it.

These back tax assessments often run into hundreds of thousands of dollars and sometimes over one million dollars. It should be remembered that these assessments are generally not imposed on a corporate giant but on a small business. For example, one real estate broker has been faced with a proposed assessment of $850,000 even though the net book value of the broker's business is only $400,000. In another case, a brokerage business with a net worth of $350,000 is faced with a proposed assessment of $720,000. We have also heard of other cases in which IRS agents have proposed financially ruinous back-tax assessments and then indicated that the assessments could be dropped if the taxpayer agrees to treat his workers as employees in the future.

Taxpayers who have such large assessments proposed against them are faced with a very real threat of bankruptcy. It should be noted that these taxpayers may be driven into bankruptcy, even though they ultimately prevail over the IRS, because of the inability to obtain credit with such a large contingent liability outstanding. Even though the IRS claim for back taxes may be totally without merit, a huge contingent liability must be disclosed in financial statements, loan applications, etc. In addition, the legal and accounting fees which must be incurred by these small business people are enormous in and of themselves. Ultimate victory over the IRS will have still cost the taxpayer many thousands of dollars for the legal and accounting fees incurred to contest the unjustified IRS claim.

Theoretically, the assessment of income and social security taxes against a newly reclassified "employer" should not result in double taxation even though each of his workers may have already paid corresponding taxes on his or her own behalf as an independent contractor. The alleged employer may be able to abate the assessment for income taxes not withheld if he can prove that his workers paid the proper amount of income taxes. In addition, the workers are theoretically entitled to claim a refund of social security taxes paid as self-employed persons. The General Accounting Office report, however, indicated that in actual practice the system of abatements and refunds does not work smoothly and that double taxation often results. Alleged employers often have difficulty in locating previous workers in order to obtain signed statements from them showing that they paid their income taxes. The burden of determining whether income taxes have been paid is placed entirely upon the alleged employer even though in many, if not most, instances the Internal Revenue Service has within its own files the records necessary to establish payment. Moreover, the GAO report indicates that the IRS does not explain to employers or employees the right of a reclassified employee to file for a refund of the self-employment taxes which he previously paid. In fact, the GAO estimates that only one in thirteen reclassified employees files a claim for a tax refund to which they are entitled.

THE REAL ESTATE INDUSTRY

The real estate industry has for decades been characterized by low entry barriers and intense competition. Due to the inherent nature of the real estate business, the industry has traditionally attracted from the more formal professions highly-motivated, self-reliant individuals who are anxious to forgo the security of regular salary and fringe benefits for the prospects of greater success based on their own efforts. Almost 30 years ago, the Eighth Circuit Court of Appeals, in characterizing the typical real estate salesperson, stated:

"Here we are concerned with competent salesmen, almost entirely dependent upon their own initiative, efforts, skill and personality for success, working upon their own time, at their own expense, and deriving their remuneration from the results of their work. (*Dimitt-Rickhoff-Bayer Real Estate Co.* v. *Finnegan*, 179 F.2d 882 (8th Cir. 1950), at p. 888)."

Under State regulations, real estate brokers are licensed to act as agents with respect to the sale of real estate. Under these same regulations, real estate salespeople are licensed to act as sub-agents for the broker in locating potential buyers and sellers of real estate. In effect, the salesperson acts as the agent of the broker who in turn acts as the agent for the seller of property.

The typical real estate salesperson pursues the objective of locating potential sellers and buyers of property in his or her own manner, without interference or control by the broker. Real estate salespeople generally set their own hours, provide their own transportation, and pay the expenses associated with their profession. They invest their time and skills with the knowledge that they will be compensated only if their efforts are successful. They are, in short, the individual entrepreneurs described by the Eighth Circuit Court of Appeals in the *Dimmitt* case, cited above.

LAWS AND RULES AFFECTING REAL ESTATE SALESPEOPLE

Regulations and early cases

With the exception of certain statutory classifications not here relevant, the touchstone for determining whether a particular worker is an employee or an independent contractor is and always has been the common law test of control. Common law control consists of the existence of the right in the employer to specify the manner and means by which an end result is to be accomplished by the employee. Where a person engaging the services of another has "the right to control and direct the individual who performs the services, but only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished," the relationship of employer and employee is generally deemed to exist. See Treasury Regulation Section 31.3401(c)-1(b). In contrast, while it is appropriate for a principal to expect results from an independent contractor, he may not control the manner in which those results are achieved.

The Internal Revenue Service has adopted 20 rules of general application to determine whether workers are employees because of the control exercised over them. As the General Accounting Office report indicates, these rules are very difficult to apply to a specific set of facts especially if one is a small businessman unsophisticated in the tax laws. Therefore, court decisions and IRS rulings applying the rules to specific situations are very important in helping taxpayers (and IRS agents auditing them) to apply the law correctly to their particular situation. In the past, Congress has occasionally carved out statutory exceptions from the definition of an employee (such as certain fishermen in 1976) when it felt that the IRS was unfairly applying the law against a particular occupation or industry. However, in recent years the IRS had broadly interpreted the laws governing independent contractors in many industries, including the real estate industry.

The history of the tax treatment of real estate salespeople as employees or independent contractors goes back many years. In 1938 the IRS issued a Social Security Tax ruling, S.S.T. 346, 1938-2 C.B. 300, which concluded that a typical real estate broker did not retain sufficient rights to control the salespeople to establish the relationship of employer and employee. Five years later, the IRS concluded that S.S.T. 346 was erroneous and published Mimeograph 5504, 1943 C.B. 1066, holding that real estate salespeople in general should be treated as employees rather than independent contractors. It is important to note that, although Mimeograph 5504 revoked Social Security Tax ruling 346, the revocation was prospective only and did not affect past years.

The courts, however, refused to accept the new position of the Service that real estate salespeople should be treated as employees rather than independent contractors. The courts held, first in *Brodcrick* v. *Squire*, 163 F.2d 980 (9th Cir. 1947) and then in the leading case of *Dimmitt-Rickhoff-Bayer Real Estate Co.* v. *Finnegan*, 179 F.2d 882 (8th Cir. 1950), that real estate salespeople should be treated as independent contractors under the authority of the decision of the U.S. Supreme Court in *Harrison* v. *Greyvan Lines*, 331 U.S. 704 (1947). The result in *Dimmitt* was accepted by the Service in Mimeograph 6566, 1951-1 C.B. 108, which revoked Mimeograph 5504 and stated that real estate salespeople would not be treated as employees where the facts are substantially similar to those of Mimeograph 5504 or the *Dimmitt* case unless other substantial evidence of an employer-employee relationship is present.

Revenue Ruling 76-136

For 25 years after the publication of Mimeograph 6566, it remained in effect as the official position of the Internal Revenue Service. Then it was superseded by Treasury Revenue Ruling 76-136, 1976-1 C.B. 312, which purports to restate the holding of Mimeograph 6566. However, the facts described in Revenue Ruling 76-136 are much narrower than Mimeograph 6566, greatly reducing the number of situations in which the IRS would conclude that a real estate salesperson was an independent contractor. A companion ruling, Revenue Ruling 76-137, 1976-1 C.B. 313, (discussed below) described a situation in which a real estate salesperson would be considered by the IRS to be an employee. Revenue Ruling 76-137 in several instances contradicts the holding of Mimeograph 6566 and the *Dimmitt* case, and it emphasizes several irrelevant and trivial facts in order to find the requisite control to establish an employer-employee relationship.

Revenue Ruling 76-136 does reflect some of the facts of the *Dimmitt* case. In both situations, the salespeople involved are remunerated on a commission basis, they receive a manual explaining the firm's business, policies, and procedures in detail, they are furnished with office space, forms and stationery, and they take turns keeping the office open on weekends. Weekly sales meetings are held, but attendance is not mandatory, although the salespeople "generally" attend. Set hours are not required, and some salespeople work only part-time. The brokerage firm is subject to sanctions for violations of state laws, regulations or rules of trade associations. The salespeople agree not to work for any other broker or make sales in their own names or on their own behalf. The salespeople pay their own expenses, including license fees.

There are, however, many aspects of the facts set forth in Revenue Ruling 76-136 which do not correspond to the facts of Mimeograph 6566.

Advances.—Revenue Ruling 76-136 specifically states that the brokerage firms do not give their salespeople advances against their commissions. This "fact" is apparently contained in Revenue Ruling 76-136 to set the stage for heavy reliance in Revenue Ruling 76-137 upon the availability of a "draw" against commissions as a factor indicating employee status. In fact, however, the *Dimmitt* opinion specifically states (179 F.2d at p. 887) that the *Dimmitt* firm occasionally made advances to a salesperson against commissions earned or to be earned.

Manuals.—Revenue Ruling 76-136 appears to downplay the brokerage firm's manual to an extent inconsistent with the *Dimmitt* case. The ruling states that the salespeople "follow" the manual, but that it is an advisory only and "not used as a basis for evaluating the salespeople's performance". The *Dimmitt* opinion makes it clear, however, that the manual in that case was regarded as the broker's instructions for the guidance of the salesmen, with which they were expected to, and did, comply in conducting business. It is clear that the manual in *Dimmitt* was viewed by the *Dimmitt* salespeople as more than merely proffered advice which could be ignored at will.

Implementation of compliance with State law.—Unquestionably, the single most serious departure from Mimeograph 6566 contained in Revenue Ruling 76-136 is the suggestion that, although a broker may "require" that his salespeople comply with regulatory legislation and established industry customs and practices without creating an employer-employee relationship, any steps he may take to "implement" such compliance will be viewed as evidence of the control necessary to make the salesperson an employee. Cited as examples of such "implementing" actions are "closely supervising or reviewing all the salesmen's activities or by requiring the salesmen to report all their activities to the broker in detail on a frequent and regular basis". The language in Revenue Ruling 76-136 with regard to "implementing compliance" with state regulatory legislation and industry practices is completely foreign to Mimeograph 6566. The reason for the language becomes clear when Revenue Ruling 76-136 is read in light of Revenue Ruling 76-137, since the latter ruling places overwhelming reliance on certain limited "implementing" actions to find an employer-employee relationship.

Revenue ruling 76-137

Revenue Ruling 76-137 is an exercise in vagueness. The ruling deals not as much with facts as with "understanding" between the salespeople and the brokerage firm. These "understandings" relate to actions which the firm "may" require in "certain circumstances" which, for the most part, remain completely unspecified. The following factors, some of which contradict the holding of Mimeograph 6566 and the *Dimmitt* case, are relied upon by Revenue Ruling 76-137 to support the classification of real estate salespeople as employees.

State registration system.—The primary thrust of Revenue Ruling 76-137 relates to the state system of registration under which the salespeople are sponsored by the brokerage firm and the registration certificate is issued in the firm's name and kept in its custody. The concluding paragraph of Revenue Ruling 76-137 indicates that the "potential control" which this registration system gives the firm over the salespeople, combined with certain "implementing" actions, taken "under some circumstances" by the firm, distinguishes the situation in Revenue Ruling 76–137 from the facts of Revenue Ruling 76–136 and the *Dimmitt* case and results in employee classification for the salespeople.

This approach appears to be an indirect attempt to establish the existence of the state registration system as a "controlling factor" requiring employee classification, contrary to the established rule that no single factor is controlling on the classification question. See Treasury Regulation Section 31.3121(d)–1(c). Thus, rather than taking its proper place as one of many factors to be considered, the state registration system is elevated to the level of "super factor".

Revenue Ruling 76–137 is curiously silent as to the "profound" effect which it indicates termination of the salesperson's relationship with the company is supposed to have on the terminated salesperson as a result of the state registration system. This probably is because in fact no such "profound" effect results in the case of the usual termination. The experienced salesperson who is terminated will usually have no difficulty associating with another brokeage firm. Securing a new certificate will generally be a routine matter so long as the termination did not occur as a result of a violation of state regulations. The fact that the firm pays for the certificate and retains custody of it does not, in and of itself, require classification of the salesperson as an employee. See, e.g., *Harrison* v. *Greyvan Lines*, 331 U.S. 704 (1947).

Further it should be noted that the state regulatory programs involving the examination, licensing and supervision of real estate salespeople have been developed by the States over the years in conjunction with representatives of the real estate industry primarily to protect the consumer when he or she engages in what in most instances amounts to the single largest financial transaction of his or her life, i.e., the purchase of a home. The National Association of Realtors, State Associaitions of Realtors, and local Boards of Realtors, as well as the National Associatfon's affiliated societies and institutes, have all been avid proponents of these regulatory and registration systems implemented by the states. The distorted interpretation of such industry sponsored state regulatory programs and registration systems illustrated by Revenue Ruling 76–137 may well result in a serious reduction in consumer protection if such regulatory and licensing programs must be changed to meet new and highly questionable standards imposed by the Internal Revenue Service. Surely Congress did not intend such a result.

Listings.—Closely related to the registration system is the factor that all listings and advertising of properties, even those of the salesperson's own property, must be made through the brokerage firm. Although Revenue Ruling 76–137 seems to place some independent emphasis on this fact, it clearly stems from state regulations which prevent real estate salespersons from pursuing their occupation in their own name. The state regulations involved in the *Dimmitt* case appear to have been similar, as the salespeople in that case also could not make sales in their own name or on their own behalf.

Implementation of control.—Revenue Ruling 76–137 becomes very vague in discussing the actions by which a broker may implement the "potential control" given by a state registration system. Its vagueness sometimes leads IRS agents to conclude that a few isolated actions by a broker with respect to a few salespeople during an undefined period of time to insure compliance with state laws should result in *all* salespeople being classified as employees.

Draw system.—Revenue Ruling 76–137 holds that a "draw" system whereby a salesperson can receive advances against commissions indicates employee status. Although a draw system was present in the *Dimmitt* case, Revenue Ruling 76–137 seeks to distinguish that system solely on grounds of form rather than substance.

Right to terminate.—The brokerage firm in Revenue Ruling 76–137 was found to be an employer in part because it had the right to discharge salespeople for any violation of its instructions, for discrediting it with the public or for failing to make sales. Obviously, principal-independent contractor relationships must be ended sometimes as well as employer-employee relationships, and it seems unfair to require that the broker retain no right to terminate the relationship. In the *Dimmitt* case, the broker had an unrestricted right to terminate a salesperson's association with the firm.

Equal treatment.—Revenue Ruling 76–137 also cites as an indication of employee status the fact that salespeople consider themselves on an equal footing with other salespeople insofar as the broker's right to control them and they expect the company requirements and restrictions to be enforced on an equal basis. Other indications cited were that commissions were divided according to a generally applicable formula between the salespeople finding the seller and the buyer and that the broker rotated outside referrals on a nonpreferential basis. The idea that each salesperson must have individualized agreement providing distinctive rights and duties in order to be an independent contractor runs directly contrary to the authorities, notably *Harrison* v. *Greyvan Lines*, 331 U.S. 704 (1947), in which the U.S. Supreme Court found truck drivers engaged under standardized agreements to be independent contractors.

PRESENT PROBLEMS CAUSED BY IRS RETROACTIVE CHANGES

Generally speaking, the Internal Revenue Service is entitled to change its position regarding the proper application of a provision of the Internal Revenue Code to a factual situation. In this case, however, the Service's change of Mimeograph 6566 was inappropriate for at least two reasons. First, the change was retroactive thus adversely affecting real estate brokers who have relied in good faith on Mimeograph 6566. Secondly, the IRS has tried to avoid Congressional and judicial supervision and has tried to reclassify real estate salespeople as employees by administrative flat.

It has long been the policy of the Internal Revenue Service to make changes in previously published positions on a non-retroactive basis, which it has the authority to do under Section 7805(b) of the Internal Revenue Code, This policy reflects a basic concept of fairness and is also necessary if the extensive program for publishing IRS rulings is to have any value to taxpayers. Revenue Rulings 76–136 and 76–137 have been applied retroactively in contradiction to this general policy because the IRS maintains they do not change the position stated in Mimeograph 6566. Revenue Rulings 76–136 and 76–137 in fact implicitly change the rule of Mimeograph 6566 that the typical real estate salesperson is an independent contractor. It should be remembered that, when the IRS revoked Social Security Tax ruling 346, the revocation was prospective only. Fairness requires that Revenue Rulings 76–136 and 76–137 be revoked in order to protect real estate brokers and salespeople who have relied in good faith on the long-established guidelines. The fact that the IRS has contended to this date that the Revenue Rulings do not change the position of Mimeograph 6566, while in fact they are being applied as a change, requires not only the withdrawal of those rulings until the matter is clarified, but assurance that any clarification will be prospective only.

The IRS has avoided judicial review of its change in position by suspending action on the audits of brokerage firms after proposing assessments but before trying to collect them. Thus the IRS has avoided a prompt judicial resolution of this dispute. In the meantime, taxpayers are left with huge proposed assessments outstanding. These huge assessments have a chilling effect and may pressure them, and also similarly situated taxpayers aware of the IRS actions, into treating their salespeople as employees in order to avoid the risk of ruinous assessments for future years. As previously mentioned, we have heard of situations in which the IRS agents have indicated that ruinous back-tax assessments may be dropped if the taxpayer agrees to treat his workers as employees in the future. Thus, the Service hopes to achieve its objective without risking a court test (which would probably be adverse to the IRS in view of the contradictions between the *Dimmitt* case and Revenue Rulings 76–136 and 76–137 discussed above).

Further, the IRS has pursued a course contradictory to the expressed wishes of Congress. The conferees on the Tax Reform Act of 1976 requested the staff of the Joint Committee on Taxation to make a general study of this area and also instructed the IRS not to apply any changed position or any newly stated position until the requested staff study was completed. Despite the urging by Congress, the Service has continued to audit real estate brokers and to apply Revenue Rulings 76–136 and 76–137 prospectively and retroactively.

POSSIBLE NEW LEGISLATIVE DEFINITIONS OF INDEPENDENT CONTRACTOR STATUS

Since the conferees on the Tax Reform Act of 1976 requested that the staff of the Joint Committee on Taxation study the classification of workers as employees or independent contractors, various actions have been taken. As mentioned above, the General Accounting Office has, at the request of the Joint Committee, prepared a report (dated November 21, 1977) on the tax treatment of employees and self-employed persons. This report discusses existing substantive and procedural problems, but it also proposed a new system to protect against abuses while prohibiting retroactive assessments, and it proposes a new test of self-employed status.

Another new standard of independent contractor status has been introduced as H.R. 13274 by Congressman Richard A. Gephardt. The new standards would apply to services performed after December 31, 1978. Services rendered before this date will be considered to have been performed as an independent contractor if such status is in accordance with long-established guidelines and is not inconsistent with a revenue ruling published prior to January 1, 1976.

While the National Association of Realtors has some reservations regarding both the General Accounting Office proposal and H.R. 13274, we applaud such efforts to pull the tax law regarding self-employed status out of the morass of confusion in which it is presently sunk as a result of IRS action. Because of the many industries and occupations that would be affected by any new future standard, Congress will likely want to study carefully its effects prior to enactment.

CONCLUSION: NEED FOR INTERIM RELIEF NOW

Congress should quickly enact S. 3007, S. 3037 and H.R. 12427 to provide taxpayers with interim relief from retroactive attacks by the Internal Revenue Service while it makes a careful study of prospective long-term solutions to the classification of individuals as employees or self-employed persons. Despite the request of the conferees on the Tax Reform Act of 1976, the IRS has continued to reclassify independent contractors as employees on a retroactive basis, applying positions inconsistent with rulings outstanding during the years under audit. Without new legislation, there is every indication that the IRS will continue in this unjustified approach. By the time that Congress enacts a new prospective standard regarding independent contractor status, there will be many more small business people faced with possible bankruptcy unless interim relief is provided now. S. 3007, S. 3037, and H.R. 12427 all provide this urgently needed interim respite. Because of the short time left in this session of Congress, the National Association of Realtors respectfully urges this Subcommittee and Congress, as a whole, to act swiftly in enacting this vital interim legislation.

Thank you for this opportunity to present our views. We will be pleased to respond to any questions the committee may have.

STATEMENT OF NEIL H. OFFEN, PRESIDENT, DIRECT SELLING ASSOCIATION

SUMMARY

DSA believes that much of the controversy involving independent contractor status is attributable to the application by the Internal Revenue Service of new and unjustified enforcement policies. IRS departure from common-law test has produced huge retroactive assessments and double taxation.

In 1977, the U.S. Court of Claims in *Aparacor, Inc.* (Queen's-Way to Fashion case) sustained the independent contractor status of direct selling representatives under the common-law test and chastised the IRS for taking an abrupt departure from existing case law and rulings in comparable situations.

There is no need for change in the definition of independent contractor status since the GAO concluded that independent contractors have relatively high tax compliance rates and because Congress has recognized the existence and importance of maintaining the status of independent contractors. Thus, DSA strongly supports continued use of the time proven and widely relied upon common-law test.

DSA also endorses the proposals of the GAO report (appearing at pages 56–8) to eliminate retroactive assessments and decrease the incidence of double taxation.

While Congress considers the reemphasis of the common law and the adoption of the procedural proposals of the GAO, however, interim solutions may be advisable. Thus, although DSA appreciates the concerns giving rise to introduction of S. 3007 and S. 3037, DSA believes that these bills should be expanded to include those industries, such as direct selling, which are not covered by S. 3007 and S.

3037. H.R. 13313 provides this expanded coverage and would treat an individual as an independent contractor if so treated consistently and in good faith. This approach would be preferable to the narrower approach of S. 3007 and S. 3037 or to any proposal which would merely suspend audits during Congressional consideration of the independent contractor/employee issue.

My name is Neil Offen and I am President of the Direct Selling Association (DSA). I am pleased to appear before you in connection with your consideration of S. 3007 and S. 3037.

DSA is a trade association consisting of over 100 direct selling companies and another 50 firms that supply goods or services to direct selling companies. Direct selling is a method of distribution which markets numerous products and services directly to consumers primarily in the home. Approximately 4,000,0000 independent direct salespeople are associated with the industry during the course of the year with 2,000,000 actively selling at any point in time. Over 80 percent of these salespeople are women, and 89 percent of all such sellers work part-time. Over 300,000 members of minority groups work as direct selling representatives, as do approximately 100,000 persons over the age of 65. Direct selling also offers self-employment opportunities to over 200,000 persons with disabilities. Sales volume for 1977 is estimated at $7.5 billion.

The keystone of the direct selling method of distribution is the independent entrepreneurial status of direct selling representatives. A Lou Harris study of direct salespersons found that they rated their independence, being their own bosses, working their own hours in their own way, as the most important element of their sales activities, even more important than money. In addition, Robert R. Nathan, our economic consultant, estimates that, conservatively speaking, should these people be found to be employees of our member corporations rather than independent retailers, it would cost us over $550 million annually accompanied by the loss of at least two-thirds of the income opportunities presently offered. DSA is, therefore, vitally interested in perserving the tax status of independent contractors and the income opportunities afforded to millions of small businesspersons throughout our industry.

DSA further believes that much of the controversy involving independent contractor status is attributable to the application by the Internal Revenue Service of new and unjustified enforcement policies. The landmark decision last year of the U.S. Court of Claims in *Aparacor, Inc.* (Queen's-Way to Fashion v. *United States*, in which the Court sustained the independent contractor status of direct sales representatives, dramatically illustrates this view. Before the adoption by the Revenue Service of these new and controversial enforcement policies, the common-law test for independent contractor status produced consistent and workable results. The Revenue Service's recent campaign has produced large assessments, jeopardizing many businesses. For example, it is known that the Service's departure from the common-law rules and the resulting retroactive tax assessments contributed to the termination of two direct selling companies, Wheatonware, a division of Wheaton Industries, and Cordon Bleu, Inc., a Minnesota corporation.

These assessments frequently involve double taxation, because the assessments duplicate taxes already paid by independent contractors. Although the Service has been notably unsuccessful in upholding its position in the courts, the large retroactive assessments and the threat of double taxation have caused great concern. Thus, the Court in *Aparacor* found an "abrupt departure from existing case law and rulings in comparable situations" on the part of the Revenue Service.

It is this "abrupt departure" by the Service from the longstanding distinction between employees and independent contractors, and the resulting retroactive assessments, that have created the pressure for Congressional action. In effect, the Revenue Service has created confusion and uncertainty for taxpayers where none previously existed.

DSA strongly supports the continued use of the common-law test and believes that proper enforcement of the law by the Service would eliminate the need for new legislation defining self-employed status. Tax compliance by independent contractors in general and direct sellers in particular is high; the Revenue Service, as pointed out by the General Accounting Office in its November 21, 1977, report on the tax treatment of employees and self-employed persons, has not even made proper use of existing compliance tools.

DSA fully supports the GAO report in calling attention to the threat of retroactive assessments by the Service and double taxation caused by these assessments, and DSA strongly endorses the proposals of the GAO (appearing at pages 56–8 of the report) to eliminate retroactive assessments and decrease the incidence of double taxation. DSA believes that these procedural changes will be extremely important in reducing the impact of problems arising from independent contractor/employee disputes for all industries.

DSA is sympathetic with the concerns of other industries over IRS harassment and overreaching in independent contractor tax controversies. As indicated, this kind of harassment has been experienced by direct selling companies in recent years. We believe, however, that Congress, consistent with the decision of the U.S. Court of Claims in *Aparacor* should put an end to efforts by the Revenue Service to distort the common-law test as applied to direct sellers.

While Congress is considering means of protecting independent contractor status and the adoption of the procedural recommendations of the GAO interim solutions may be advisable. We appreciate the concerns giving rise to the introduction of S. 3007 and S. 3037, we believe that an expansion of the protections sought in these bills will be of significant value to the many potential victims of excessive and unjustified IRS enforcement efforts. S. 3037 is specifically limited to reversing two IRS revenue rulings dealing with real estate brokers. We respectfully suggest that other industries be likewise afforded protection from IRS harassment. Similarly, S. 3007 is of limited value in requiring the Revenue Service to apply audit positions, regulations and rulings in effect on December 31, 1975. While this language would in some cases assist certain industries, industries with which we are in sympathy, it is unclear and imprecise as to many others. In many cases, shifts in IRS audit positions took place before December 31, 1975, and thus, S. 3007 would not help as many taxpayers faced with IRS audits as could be through broadening its scope.

If the Committee wishes to provide protection to taxpayers from IRS harassment while Congress considers measures to protect the common-law status of independent contractors and adoption of the procedural proposals of the GAO, we commend to the attention of the Committee the approach of H.R. 13313. (A copy of the bill is appended hereto.) This will would require that until specifically repealed, an individual would not be treated as an employee of any person if the latter, *in good faith*, consistently treated such individual as an independent contractor.

We consider the approach of H.R. 13313 to be preferable to S. 3007 and S. 3037 because of its broader applicability. We believe S. 3007 and S. 3037 assist one or two industries but a dozen or so are concerned with the issue. We, therefore, suggest that the more preferable way is to adopt the broader and more comprehensive approach of the consistent treatment, good faith test contained in H.R. 13313. We also consider it to be preferable to any proposal which would merely suspend audits during Congressional consideration of the independent contractor/employee issue. Such a suspension would increase the present uncertainty about the results of these audits and could result in the creation of contingent tax liabilities involving numerous taxpayers and huge sums of money that could not be resolved until substantive action is taken by the Congress, action which could require a considerable period of time to develop. We also have reason to believe that a mere suspension of audits will adversely impact on companies seeking financing and on publicly held corporations which would incur significant legal and accounting fees to determine the S.E.C. reporting requirements in regard to such audits. The possible negative impact on stock market activities should also be taken into consideration.

In conclusion, we wish to reaffirm once again our fundamental support for the common-law test and to urge that prompt attention be given to the enactment into law of the GAO recommendations for procedural changes that would reduce the possibility of double taxation in independent contractor/employee disputes. We believe that retention of the common-law test and adoption of these procedural changes will alleviate most of the pressure in this area. Adoption of the concept embodied in H.R. 13313 will provide interim relief for all industries which have consistently and in good faith treated persons as independent entrepreneurs.

We appreciate the opportunity of testifying on this matter of vital concern to our industry and the country as a whole.

APPENDIX

H.R. 13313

A BILL To disregard, for purposes of certain taxes imposed by the Internal Revenue Code of 1954 with respect to employees, certain changes from common law in the treatment of individuals as employees

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) except as provided in subsection (b), the determination of whether any individual is an employee for purposes of chapters 21 (relating to Federal Insurance Contributions Act), 23 (relating to Federal Unemployment Tax Act), and 24 (relating to collection of income tax at source on wages) of the Internal Revenue Code of 1954 shall be made under Internal Revenue Service practices, interpretations, and regulations in effect on December 31, 1975.

(b) Notwithstanding subsection (a), an individual shall not be treated as an employee of any person for purposes of chapters 21, 23, and 24 of the Internal Revenue Code of 1954 if such person, in good faith, consistently treated such individual as an independent contractor for such purposes.

(c) This Act shall apply until enactment of any law which expressly repeals this Act.

STATEMENT OF FRANCIS O. MCDERMOTT ON BEHALF OF THE NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

SUMMARY

1. The National Association of Independent Insurers (NAII) supports the objectives contained in S. 3007 and related bills, and commends the authors of these bills for their time and effort devoted to recognition of the employment classification problem.
2. This Committee should give attention to a more permanent legislative solution than is contained in S. 3007, one that would provide both prospective as well as retroactive relief. In this regard, NAII recommends that this Committee consider the approach taken by Congressman Gephardt in his bipartisan bills, H.R. 12176 and H.R. 13274.
3. During the interim period before a more permanent legislative solution as suggested can be attained, NAII urges this Committee to expand the present recommendations of the sponsors of S. 3007, to insure a broader and more complete protection of those industries which are beset by the harassment techniques of the Internal Revenue Service.

STATEMENT

Mr. Chairman and Members of the Subcommittee: My name is Francis O. McDermott. I am an attorney in private practice here in Washington, D.C., and appear before you today on behalf of my client, the National Association of Independent Insurers (NAII).

NAII is a voluntary insurance company trade association with more than 400 members, with headquarters in Des Plaines, Illinois. Companies, both members and subscribers, now affiliated with the organization total over 600. Companies within the membership range from the small, one-state type of company to the largest multi-state writer; from the highly specialized writer of farmers or other consumer groups to the so-called full multiple-line insurer; and from those merchandising their insurance product through the mails to those using the American Agency System. Virtually every state is represented in the membership. Thus, association policy is developed on the basis of a very broad consensus of the insurance industry.

I appear on NAII's behalf, in regard to two bills dealing with the status of individuals as employees. S. 3007, introduced by Senator Dole, which would prohibit the Internal Revenue Service from applying any position changed since 1975 with respect to the status of individuals for employment tax purposes, until Congress acts to amend the Internal Revenue Code, and S. 3037, introduced by Senator Domenici, which provides for similar relief applicable only to the real estate industry.

NAII supports the goals and objectives of these bills. We applaud the recognition by both S. 3007 and S. 3037 of the problem of inequity in employment taxes especially for the real estate industry, but we believe neither bill is broad enough in application, even as an interim measure. Further, as S. 3007 implies, the need for a permanent legislative policy on employment status for all industries is something that Congress must deal with substantively in the very near future. A legislative approach is urgently necessary to affirm that it is Congress, not the Internal Revenue Service, who must formulate this policy.

In this regard, NAII strongly recommends this committee adopt the bipartisan approach introduced in the House by Congressman Gephardt, embodied in H.R. 12176 and as amended in his subsequent bill, H.R. 13274. The Gephardt bills incorporate prospective and retroactive solutions to the employment classification dilemma, thereby achieving the permanent legislative policy envisioned in S. 3007 and related bills. I ask that a copy of H.R. 12176 and H.R. 13274 be included in the record as part of my testimony.

The Gephardt bills are designed to clarify standards for determining the status of individuals for employment tax purposes, and in particular provide much needed retroactive relief where the service has assessed employment taxes on the basis of recently promulgated, private, unpublished technical advice memoranda holding that commission agents should be treated as employees. This IRS procedure is in total disregard of 30 years of IRS rulings that commission insurance agents should be classified as independent contractors and not as employees for employment tax purposes. Moreover, the courts have in several cases agreed with this conclusion. There are no published rulings or judicial decisions to the contrary. These assessments represent, for the most part, duplication of Federal income and self-employment taxes already paid by agents. Consequently, the imposition of assessments on the employers as well results in an unfair double taxation. The service's retroactive change in position is not limited to the insurance agency, however, as shown by the government's assertion in a recent Court of Claims case that individuals engaged in selling products at retail solely on a commission basis were employees. The Court did not agree, and characterized the government's position as a "radical departure from the traditional common-law concept of an employer-employee relationship." (*Aparacor, Inc.* v. *United States*, 556 F. 2d 1004, 1012–1013 (Ct. Cl. 1977).)

The Gephardt bills also provide the more permanent prospective relief envisioned in S. 3007 by establishing only five conditions for determining an individual's status for employment tax purposes.

The industry was encouraged by the initiative of the Finance Committee when it considered the Tax Reform Act of 1976 and directed a study by the Joint Committee staff regarding the definition of "independent contractor" as contrasted to "employees." The committee went further and strongly urged the Internal Revenue Service not to issue retroactive revenue rulings in this area until after completion of the staff study. Subsequently, this directive was the subject of a colloquy between the distinguished chairman of the Finance Committee, Senator Long, and Senator Curtis, which took place on July 26 when the Tax Reform Act was being considered by the full Senate. It was construed to mean, in essence, that the IRS should not be able to change the rules of the game on a retroactive basis and that, if there was a controversy, its actions should be prospective only. The conferees on the Tax Reform Act in the Joint Statement of Managers endorsed this approach particularly regarding retroactive changes by IRS.

Regrettably, in our experience, IRS has chosen to ignore this congressional mandate and continues to proceed in its assertion of liability for employment taxes on a retroactive basis, imposing this harsh treatment on member companies which have relied on long-standing revenue rulings and audit practices of the IRS and filed their employment tax returns for numerous years on the basis that their agents are legally and factually independent contractors.

In the overall, most companies are generally those that fall in a small or medium sized category. They, of course, are most susceptible to attack since they have neither the legal staff nor resources to combat the IRS. Further, the potential tax liability for many looms as a threat to their continued economic life.

In November, 1977, the General Accounting Office (GAO) submitted a report to the Joint Committee regarding this problem and highlighted certain IRS practices with proposed solutions, failing however, to propose a solution to the retroactive problem. The Joint Committee thereafter requested comments from affected industries and interested parties on the GAO study which were to be submitted by March 10, 1978, in line with the Joint Committee staff study on the independent contractor issue.

The Committee on Ways and Means of the House of Representatives, recognizing this problem and stimulated by a number of bills on this subject, just recently established a task force to study and report to the full committee on the independent contractor issue. This is the legislative picture to date and forms a background for consideration by members of the subcommittee of this issue.

Recognizing the time frame and the need that exists for specific relief, we are particularly pleased that the subcommittee is directing its attention and effort to some retroactive recognition of the problem. We realize that a more permanent solution to the employment classification problem cannot be achieved before the Senate's proposed adjournment on October 7, 1978. Recognizing this, NAII certainly supports retroactive relief. However, we do not believe that the specific language of S. 3007 is broad enough to accomplish this objective.

Two problems exist with the language of S. 3007 as presently drafted. First, the date establishing the general audit position of January 1, 1976, is not broad enough. In 1969, the IRS intensified its audit activity in this area, and in 1970, general audits of employment tax compliance on independent contractor status were commenced with most industries. Thus, if a corporation was audited prior to 1976, and similar corporations in the industry were thereafter audited, the IRS has already established a set audit procedure, and most industries with a 1976 date would be adversely affected.

Second, S. 3007 contains insufficient criteria in its test to insure compliance by the IRS. The Service is given too much discretion and this has proven to be detrimental in the past. IRS' total disregard of the prohibitions contained in the conference report of the Tax Reform Act of 1976 are evidence of this.

To rectify these two problems, NAII recommends a proposal that contains a more adequate cut-off date and sets forth criteria which provide better guidelines in assuring less discretion by the IRS avoiding this congressional mandate.

Our proposal, a copy of which is attached to my statement, changes the cut-off date for the service's general audit position, regulations, or ruling to January 1, 1970. It also adds a third criterion for determining employment status in order to insure broader protection.

In conclusion, we are vitally interested, as all affected industries beset with this perplexing problem, in resolving this issue.

We agree something must be done now, and the interim relief being considered, and broadened as suggested, should be enacted to insure that the IRS does no further damage to companies which have relied on long-standing practices and in many instances published, unrevoked IRS rulings.

However, this stop-gap action should not replace a more permanent legislative solution so necessary to resolve the litigation and controversy with the IRS over the independent contractor-employment tax problem.

A BILL

To disregard, for purpose of certain taxes imposed by the Internal Revenue Code of 1954 with respect to employees, certain changes since 1970 in the treatment of individuals as employees

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. That until enactment of any law amending the definition of term "employee" for purposes of chapters 21, 23 and 24 of the Internal Revenue Code of 1954, in determining whether an individual is an employee for purposes of sections 3121, 3306, and 3401 of the Internal Revenue Code of 1954, there shall not be applied any changed or newly stated position which is inconsistent with (i) the general audit position of the Internal Revenue Service in effect prior to January 1, 1970; or (ii) the status of such individual as reported in tax returns or statements filed by the person for whom such individual performed services where the status as reported is in accordance with the consistent practice of such person with respect to individuals performing such services; or (iii) a regulation or ruling in effect on January 1, 1970.

95TH CONGRESS
2D SESSION

H. R. 12176

IN THE HOUSE OF REPRESENTATIVES

APRIL 18, 1978

Mr. GEPHARDT (for himself, Mr. HOLLAND, Mr. STEIGER, Mr. FRENZEL, Mr. FORD of Tennessee, Mr. TUCKER, and Mr. DUNCAN of Tennessee) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to clarify standards for determining status of individuals for employment tax purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. (a) Chapter 25 of the Internal Revenue Code of 1954 (relating to general provisions for employment taxes) is amended by adding at the end thereof the following new section:

"SEC. 3507. CLARIFICATION OF STANDARDS FOR CLASSIFICATION AS INDEPENDENT CONTRACTOR OR SELF-EMPLOYED PERSON.

"(a) If, for any calendar year, the classification as an independent contractor or self-employed person of any individual described in subsection (b) either (1) is not inconsistent with a revenue ruling published prior to January 1, 1977, relating to the industry in which such individual rendered services and which was outstanding during such calendar year, or (2) has been consistently so reported on tax returns or statements filed by the person for whom such services were performed, and is in accordance with the longstanding practice of such person with respect to individuals performing such services, then the classification of such individual shall be as an independent contractor or self-employed person and not as an employee during such calendar year for all purposes under chapters 21, 23, and 24.

"(b) This section shall apply to any individual (other than an individual described in section 3121(d)(3)) if, during a given calendar year (1) such individual was performing services under an agreement which provided that such services were performed as an independent contractor or self-employed person, (2) the sole remuneration for such services during such calendar year was by commissions (including prizes, awards, overrides or other economic benefits related to production or performance, but not including salary payments) which were reported by the person for whom such services were performed as commissions, fees or other compensation related to nonemployee services paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a); and (3) such individual was not required to work during specified hours or to follow a prescribed daily or weekly work schedule.

"(c) This section shall apply to services performed before January 1, 1979."

(b) The table of sections for such chapter is amended by adding at the end thereof the following new item:

"SEC. 3507. Clarification of standards for classification as independent contractor or self-employed person.".

SEC. 2. Section 3121 (b) of the Internal Revenue Code of 1954 (relating to the definition of the term "employment" for purposes of the Federal Insurance Contributions Act) is amended by striking out "or" at the end of paragraph (19), by striking out the period at the end of paragraph (20) and inserting in lieu thereof "; or ", and by adding after paragraph (20) the following new paragraph:

"(21) service performed by an individual (other than an individual described in section 3121 (d) (3)) for a person if—

"(A) the sole remuneration for such service service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

SEC. 3. Section 1402 (c) (2) of the Internal Revenue Code of 1954 (relating to the definition of the term "trade or business" for purposes of the tax on self-employment income) is amended by striking out "and" at the end of subparagraph (E), by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof ", and", and by adding after subparagraph (F) the following new subparagraph:

"(G) service described in section 3121 (b) (21);"

SEC. 4. Section 3306 (c) of the Internal Revenue Code of 1954 (relating to the definition of the term "employment" for purposes of the Federal Unemployment Tax Act) is amended by deleting paragraph (14) thereof and by inserting the following new paragraph in lieu thereof:

"(14) service performed by an individual for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses;"

SEC. 5. Section 3401 (a) of the Internal Revenue Code of 1954 (relating to the definition of the term "wages" for income tax withholding purposes) is amended by striking out the period at the end of paragraph (17) and inserting in lieu thereof "; or", and by adding after paragraph (17) the following new paragraph:

"(18) for service performed by an individual for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

SEC. 6. (a) Section 210(a) of the Social Security Act is amended by striking out "or" at the end of paragraph (19), by striking out the period at the end of paragraph (20) and inserting in lieu thereof "; or ", and by adding after paragraph (20) the following new paragraph:

"(21) service performed by an individual (other than an individual described in subsection (j) (3)) for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

(b) Section 211 (c) (2) of such Act is amended by striking out "and" at the end of subparagraph (E), by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof", and", and by adding after subparagraph (F) the following new subparagraph:

"(G) service described in section 210(a)(21) of this title;".

SEC. 7. The amendments made by sections 2 through 6 shall apply to service performed after December 31, 1978.

95TH CONGRESS
2D SESSION

H. R. 13274

IN THE HOUSE OF REPRESENTATIVES

JUNE 28, 1978

Mr. GEPHARDT (for himself, Mr. WHITEHURST, Mr. STOCKMAN, Mr. JENKINS, Mr. PATTERSON of California, Mr. GLICKMAN, Mr. QUIE, Mr. YOUNG of Missouri, Mr. THONE, Mr. HEFTEL, and Mr. JACOBS) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to clarify standards for determining status of individuals for employment tax purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. (a) Chapter 25 of the Internal Revenue Code of 1954 (relating to general provisions for employment taxes) is amended by adding at the end thereof the following new section:

"SEC. 3507. CLARIFICATION OF STANDARDS FOR CLASSIFICATION AS INDEPENDENT CONTRACTOR OR SELF-EMPLOYED PERSON.

"(a) If, for any calendar year, the classification as an independent contractor or self-employed person of any individual described in subsection (b) either (1) is not inconsistent with a revenue ruling published prior to January 1, 1976, relating to the industry in which such individual rendered services and which was outstanding during such calendar year, or (2) has been consistently so reported on tax returns or statements filed by the person for whom such services were performed, and is in accordance with the long-standing practice of such person with respect to individuals performing such services, then the classification of such individual shall be as an independent contractor or self-employed person and not as an employee during such calendar year for all purposes under chapters 21, 23, and 24.

"(b) This section shall apply to any individual (other than an individual described in section 3121 (d) (3)) if, during a given calendar year (1) such individual was performing services under an agreement which provided that such services were performed as an independent contractor or self-employed person, (2) the sole remuneration for such services during such calendar year was by commissions (including prizes, awards, overrides or other economic benefits related to production or performance, but not including salary payments) which were reported by the person for whom such services were performed as commissions, fees or other compensation related to nonemployee services paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a); and (3) such individual was not required to work during specified hours or to follow a prescribed daily or weekly work schedule.

"(c) This section shall apply to services performed before January 1, 1979."

(b) The table of sections for such chapter is amended by adding at the end thereof the following new item:

"SEC. 3507. Clarification of standards for classification as independent contractor or self-employed person.".

SEC. 2. Section 3121 (b) of the Internal Revenue Code of 1954 (relating to the definition of the term "employment" for purposes of the Federal Insurance Contributions Act) is amended by striking out "or" at the end of paragraph (19), by striking out the period at the end of paragraph (20) and inserting in lieu thereof "; or ", and by adding after paragraph (20) the following new paragraph:

"(21) service performed by an individual (other than an individual described in section 3121 (d) (3)) for a person if—

"(A) the sole remuneration for such service service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

SEC. 3. Section 1402 (c) (2) of the Internal Revenue Code of 1954 (relating to the definition of the term "trade or business" for purposes of the tax on self-employment income) is amended by striking out "and" at the end of subparagraph (E), by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof ", and", and by adding after subparagraph (F) the following new subparagraph:

"(G) service described in section 3121 (b) (21);"

SEC. 4. Section 3306 (c) of the Internal Revenue Code of 1954 (relating to the definition of the term "employment" for purposes of the Federal Unemployment Tax Act) is amended by deleting paragraph (14) thereof and by inserting the following new paragraph in lieu thereof:

"(14) service performed by an individual for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses;"

SEC. 5. Section 3401 (a) of the Internal Revenue Code of 1954 (relating to the definition of the term "wages" for income tax withholding purposes) is amended by striking out

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the period at the end of paragraph (17) and inserting in lieu thereof "; or", and by adding after paragraph (17) the following new paragraph:

"(18) for service performed by an individual for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

SEC. 6. (a) Section 210(a) of the Social Security Act is amended by striking out "or" at the end of paragraph (19), by striking out the period at the end of paragraph (20) and inserting in lieu thereof "; or ", and by adding after paragraph (20) the following new paragraph:

"(21) service performed by an individual (other than an individual described in subsection (j) (3)) for a person if—

"(A) the sole remuneration for such service performed by such individual for such person is by commissions (including prizes, awards, overrides, or other economic benefits related to productivity or performance, but not including salary payments) which are reported by such person as commissions, fees or other compensation related to nonemployee service paid to an independent contractor, in the form and manner prescribed by the Secretary pursuant to section 6041 (a),

"(B) the individual performs such service pursuant to a written contract which provides that the service is performed as an independent contractor or self-employed person,

"(C) the individual is not required by the person for whom such service is performed to work during specified hours or to follow a prescribed daily or weekly work schedule,

"(D) the individual provides his own principal place of business, or if his principal place of business is provided by the person for whom such service is performed, the individual pays such person rent therefor at a rate which is not less than the fair rental rate for comparable places of business in the community in which such principal place of business is located, and

"(E) the individual has an opportunity of making a profit or incurring a loss, in that current operating income may or may not exceed current operating expenses."

(b) Section 211 (c) (2) of such Act is amended by striking out "and" at the end of subparagraph (E), by striking out the semicolon at the end of subparagraph (F) and inserting in lieu thereof", and", and by adding after subparagraph (F) the following new subparagraph:

"(G) service described in section 210(a)(21) of this title;".

SEC. 7. The amendments made by sections 2 through 6 shall apply to service performed after December 31, 1978.

STATEMENT OF JEROME B. LIBIN, SUTHERLAND, ASBILL & BRENNAN, WASHINGTON, D.C., ON BEHALF OF VARIOUS INSURANCE COMPANIES

SUMMARY

1. The Internal Revenue Service has not adhered fully to the directive in the Conference Report of the Tax Reform Act of 1976 that it not apply any changed or newly stated position in the employment tax area until Congress considers the question. Since Congress adopted the 1976 Act Conference Report, pending cases have been pursued, new audits have been started and completed, assessment and collection have occurred, and litigation has commenced.

2. S. 3007 focuses appropriately on one of the fundamental questions raised by the IRS's current policies, namely, retroactivity. However, the bill's operative date for freezing IRS audit policies (January 1, 1976) renders it a virtually meaningless bill for most industries affected by the problem. A cut-off date of January 1, 1970, is necessary in order to provide adequate relief.

3. If a bill such as S. 3007 is to be enacted, Congress should clarify the bill to permanently preclude retroactive assessments in those situations where the taxpayer's prior consistent practice was unchallenged. At the very least, Congress should strongly urge the Commissioner of Internal Revenue to exercise the discretion granted to him under section 7805(b) of the Internal Revenue Code to apply on a prospective basis only, following appropriate public notice, any audit position that constitutes a departure from prior audit practice in the employment tax area.

STATEMENT

Mr. Chairman and Members of the Subcommittee: I appear before you today as counsel for the following insurance companies:

Kansas Farm Bureau Life Insurance Co.
Farm Bureau Mutual Insurance Co.
KFB Insurance Co., Manhattan, Kans.
Mutual of Omaha Insurance Co.
United Benefit Life Insurance Co., Omaha, Nebr.
Southern Farm Bureau Life Insurance Co.
Southern Farm Bureau Casualty Insurance Co.
Mississippi Farm Bureau Mutual Insurance Co., Jackson, Miss.
Kentucky Farm Bureau Mutual Insurance Co.
FB Insurance Co., Louisville, Ky.
United Farm Bureau Family Life Insurance Co.
United Farm Bureau Mutual Insurance Co., Indianapolis, Ind.

Each of the companies we represent is currently engaged in a controversy with the Internal Revenue Service (IRS) regarding the proper classification of this insurance agents for Federal employment tax purposes. As I will explain more fully below, those controversies are at different stages of development at the present time. In addition to the insurance companies listed above, our firm represents companies in the trucking, gasoline service station, and certain other industries in connection with their pending employment tax disputes.

The Subcommittee is well aware that current Congressional concern with the independent contractor-employee issue and the efforts of the IRS to reclassify various individuals as employees on a retroactive basis had its genesis in the Report of the Senate Finance Committee relating to the Tax Reform Act of 1976 ("the 1976 Act"). Ultimately, the 1976 Act Conference Report, which was approved by the entire Congress, requested the Staff of the Joint Committee on Taxation to study the employment tax area generally and instructed the IRS not to apply any changed or newly stated position in the area with respect to past years until the Joint Committee Staff had completed is study. See H.R. Rep. 94-1515, 94h Cong., 2d Sess. 489 (1976); S. Rep. No. 94-938, 94th Cong., 2d Sess. 604 (1976); 122 Cong. Rec. S12495-96 (daily ed. July 26, 1976) (colloquy of Senators Long and Curtis).

Unfortunately, in the nearly two years that have elapsed since Congress adopted the 1976 Act Conference Report, not only has the IRS failed to promulgate new classification guidelines that would eliminate the confusion in the area for future years, but it has also failed to fully respect both the letter and the spirit of the Report itself. That this is so is perhaps best illustrated by specific reference to the employment tax cases of the companies on whose behalf I am appearing today.

Kansas Farm Bureau Life Insurance Company, Farm Bureau Mutual Insurance Company, and KFB Insurance Company of Manhattan, Kan.—Although the IRS had not previously challenged the employment tax status of the insurance agents of the Kansas Farm Bureau Companies, a dispute has arisen following an audit that began on October 8, 1976, a few weeks after adoption of the 1976 Act Conference Report. On April 3, 1978, the companies received letters proposing assessments for the taxable years 1974–76 of over $5.8 million. On June 6, 1978, less than two months ago, the companies filed a 136 page protest to those proposed assessments with the District Director of Internal Revenue in Wichita.

United Farm Bureau Family Life Insurance Company and United Farm Bureau Mutual Insurance Company of Indianapolis, Ind.—These companies received an adverse technical advice memorandum from the National Office of the IRS in May, 1976. The technical advice memorandum was issued with respect to the years 1969 and 1970 and related to proposed assessments of nearly $1.7 million. Notwithstanding the directive in the 1976 Act Conference Report, this case has continued to be processed through IRS appeal channels. A conference was held with the IRS Appellate Division in Indianapolis in June, 1977, at which time it was agreed that the Service's audit of the companies' employment tax returns for later years would be consolidated with the 1969–70 case. On January 20, 1978, the companies received letters proposing assessments of $5.2 million in back employment taxes for the years 1973–75. A second conference with the Appellate Division was scheduled for July 11, 1978, but was recently postponed until September.

Mutual of Omaha Insurance Company and United Benefit Life Insurance Company of Omaha, Nebr.—Prior to adoption of the 1976 Act Conference Report, these companies had received a proposed employment tax assessment for the year 1969 of nearly $1 million. The proposed assessment was the result of an audit begun in 1971. Subsequent to the issuance of the 1976 Act Conference Report, a conference was held with the IRS Appellate Division in Omaha. Ultimately, in April, 1977, seven months after the Conference Report, the two companies were actually assessed a total of $1.4 million in back taxes and interest. The companies had no choice but to pay a portion of that assessment and institute a refund suit, which they did in the United States Court of Claims on February 6, 1978.

More recently, the IRS completed its audit of the companies' employment tax returns for five subsequent years (1970–74). On June 12, 1978, the IRS issued letters proposing additional employment tax assessments (exclusive of interest) totaling $10.6 million. The companies' response to the proposed assessments is due August 30, 1978. The recent audit dramatically illustrates the extreme position that the IRS is now taking—the proposed assessment for 1971 is directly contrary to a favorable technical advice memorandum issued with respect to the companies in November of that year.

Southern Farm Bureau Life Insurance Company, Southern Farm Bureau Casualty Insurance Company, and Mississippi Farm Bureau Mutual Insurance Company of Jackson, Miss.—These companies received employment tax assessments proposed for the years 1970–72 totaling $9.1 million. The companies have had a request for technical advice pending in the National Office of the IRS since December, 1974. However, we have recently learned that a formal decision on that request will not be issued for the time being.

Kentucky Farm Bureau Mutual Insurance Company and FB Insurance Company of Louisville, Ky.—These companies have had a request for technical advice pending in the IRS National Office since September 1975. Their case involves proposed assessments for the years 1971–73. In March, 1977, six months after the 1976 Act Conference Report, a conference on the technical advice request was held at the National Office. We have recently learned that no formal action will be taken in this case for the time being either.

The cases summarized above demonstrate the breadth of the current problem: they involve proposed or actual assessments of over $33 million, and many of the companies, all of which have consistently treated the affected individuals as independent contractors, have substantial additional exposure for subsequent years not yet under audit. Perhaps more important, the cases conclusively establish that, so far as we are aware, only in limited instances (i.e., where the matter was still pending in the IRS National Office when the 1976 Act Conference Report was adopted) has the IRS respected Congress's request that employment tax cases involving a change of IRS position for past years should be held in abeyance pending the completion of the Joint Committee Staff study of the area.

In short, since the Conference Report was adopted, pending cases have been pursued, new audits have been started and completed, assessment and collection have occurred, and litigation has commenced.

In light of the foregoing, it seems imperative that Congress take specific legislative action to bring order out of chaos. Given the breadth and magnitude of the problem, a broad solution dealing with both past and future years is the only possible way to resolve the question on any sort of a permanent basis. A bill has been introduced in the House of Representatives by Congressman Gephardt of Missouri (H.R. 13274, superseding H.R. 12176) that addresses the issues in a very constructive manner. It is hoped that a companion bill will soon be introduced in the Senate and that an effort will be made to focus on the entire problem in this session of Congress.

If, however, there is insufficient time in this session to deal with the question on a broad-scale basis, it is necessary to consider the effect of S. 3037 and S. 3007, the bills before this Subcommittee today.

S. 3037, which was introduced by Senators DeConcini and Haskell, would afford relief only to the real estate industry. It proceeds on the premise that all other industries have established an accord with the IRS consistent with the 1976 Act Conference Report. As indicated above, however, that is simply not the case. Thus, S. 3037 is no answer to the basic questions of tax administration that must be dealt with in this area.

S. 3007, introduced by Senator Dole, appears to focus more appropriately on one of the two fundamental questions raised by the IRS's current policies, namely, whether present audit positions that attempt to reclassify as employees individuals who have consistently been treated as independent contractors should be applied retroactively. S. 3007 provides that until Congress amends the definition of an "employee" for employment tax purposes, the IRS shall not apply any changed or newly stated position which is inconsistent with a general audit position in effect prior to January 1, 1976, or which is inconsistent with a ruling or regulation in effect on December 31, 1975.

To the extent S. 3007 is intended to have general application, its purpose is laudatory. Unfortunately, however, the bill's operative date for freezing IRS audit policies (January 1, 1976) renders S. 3007 virtually meaningless for most of the industries affected by the problem. The IRS might well interpret the bill as sanctioning the position it has taken in any employment tax audit commenced before January 1, 1976, even though such audit position may have been formulated as part of the general IRS effort in this area that led to the 1976 Act Conference Report directive. For this reason, we support the January 1, 1970 cutoff date proposed by the National Association of Independent Insurers. This earlier cutoff date is imperative if the legislation is to be at all effective with respect to the numerous industries whose members are currently faced with millions of dollars of potential assessments.

Another problem with S. 3007 is that its ultimate effect is unclear. Will the IRS be free to reassert its present audit position for back years whenever Congress finally enacts a law amending the definition of an "employee"? Or is the IRS to be permanently precluded from asserting retroactive assessments in any case where the taxpayer has consistently treated the individuals who performed services for him as independent contractors in past years, without earlier audit challenge?

The later result, which we would strongly advocate, seems almost to be required by, and certainly would be entirely consistent with, the recent decision of the Supreme Court in *Central Illinois Public Service Co.* v. *United States*, 46 U.S.L.W. 4163 (Feb. 28, 1978), which unanimously rejected an attempt by the IRS to treat employee lunch reimbursements as "wages" subject to withholding on a retroactive basis. Significantly, just last week, presumably in recognition of the decision in *Central Illinois*, the IRS announced that it would apply without retroactive effect a 1975 adverse ruling dealing with the employment tax classification of market survey interviewers. (See Rev. Rul. 78-284, 1978-28 I.R.B. 8, which held that Rev. Rul. 75-243, 1975-1 C.B. 322, will be applied only from 1975 forward.)

If a bill such as S. 3007 is to be enacted, Congress should clarify the bill to permanently preclude retroactive assessments in those situations where the taxpayer's prior consistent practice was unchallenged. At the very least, Congress should strongly urge the Commissioner of Internal Revenue to exercise the discretion granted to him under section 7805(b) of the Internal Revenue Code to apply on a prospective basis only, following appropriate public notice, any audit position that constitutes a departure from prior audit practice in the emloyment tax area.

Senator BYRD. The committee will now call on the Treasury Department, Mr. Samuels, Deputy Tax Legislative Counsel. Would you express your views?

STATEMENT OF JOHN M. SAMUELS, DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. SAMUELS. Yes. Thank you very much, Senator.

I think the Treasury Department agrees with each of the witnesses who has testified in this area that a legislative solution is needed. It is one of the most vexing problems in the administration of the tax law. It involves not only the income tax but the social security tax and unemployment compensation. An independent contractor, as you know, pays estimated taxes and his social security taxes are SECA taxes. So we are talking not only about the income tax, but about the Social Security Trust Fund and the integrity of the Social Security Trust Fund.

The Treasury Department, however, does not believe that this problem should be solved with piecemeal legislation. We think it is only after Congress has carefully and deliberately studied this entire area that legislation should be enacted. We have been working for well over a year with the Internal Revenue Service and the Justice Department on a legislative proposal to clarify the law in this area.

The problem is really not the Internal Revenue Service. It is the vagueness of the standard of who is an employee and who is not. The concept of employee basically turns on whether or not the employer has a right to control the person performing the services.

Well, that is a concept that was drawn up in common law in England hundreds and hundreds of years ago to determine tort liability—whether the master was responsible for the injuries caused by his servant. In that connection, whether or not the employer has control over the employee makes sense.

But I do not think, in all cases, that standard should make sense as to how income taxes are collected.

Now, Senator Curtis correctly observed, I think, with respect to income taxes and generally with respect to social security taxes it should not matter whether a person is an employee or independent collector. If the taxes are withheld from the employee he does not have to pay estimated taxes. If social security taxes, or FICA, are paid by the employer, he does not have to pay SECA.

So from a purely income tax and social security tax point of view, the employer and employee should be indifferent. Now, unemployment compensation covers only employees and not independent contractors. There is a difference there. And there is a slight difference in social security taxes. Higher social security taxes are paid in an employment relationship.

We would urge the committee to not take any action in this area until there has been an opportunity for full, public hearings and solving the problem not only for past years but for the future as well.

Now, with respect to the past, I would like to say that the Internal Revenue Service has been making every effort to comply with the mandate of the Congress as expressed in the conference report in the 1976 act. Since September 13, no new revenue rulings have been published classifying independent contractors or persons who were independent contractors as employees.

Similarly, with respect to any issue which came to the attention of the national office where new ground was being broken in this area, the case would be suspended, put in suspense. There are a number of cases right there, right now, that are in suspense.

Senator BYRD. You referred to the mandate of the conference report. What is the mandate of the conference report?

Mr. SAMUELS. I have the language here, Senator. It says:

> The conferees also join in urging the Internal Revenue Service not to apply any changed position or any newly-stated position which is inconsistent with a prior general audit position in this general subject area to past as opposed to future taxable years until the requested staff study has been completed.

I think what the Congress was addressing itself to was the difficult problem of these very large, retroactive assessments. They said, we do not want you changing your position and then applying that changed position to past years.

Senator BYRD. Well, then the Internal Revenue does not apply it to past years?

Mr. SAMUELS. Well, the Internal Revenue Service is a very large organization and——

Senator BYRD. Does it, or does it not?

Mr. SAMUELS. At least in the national office, it does not apply any changed position to back years. Now, the problem is if an employer, say, is running a factory and he has employed—the persons who work on an assembly line are clearly employees. He has never treated them that way, but, similarly, he has never been audited. He has never been audited for employment taxes.

Now——

Senator BYRD. I am trying to get clear, still, as to whether the Internal Revenue Service has or has not applied it to past years.

Mr. SAMUELS. They have not applied any changed audit position to past years—I mean, there may have been a case of an agent in the field who has done it. As soon as it has come to the attention of the national office, that case has been suspended.

However, what the definition of a changed position is to a particular taxpayer may be different than a change in a general audit position. This taxpayer was not audited. His competitor across the street may have been audited years ago and may now be treating these people as employees. The taxpayer who was just audited may not, and to him, this is a change.

Now, that is the problem. The conference report said change from general audit position. The only way the Service could interpret that is to ask have we changed from our audit guidelines—which they have not—or have we changed from any published ruling, revenue ruling, or regulation, which they have not.

In other words, they have been sticking to all rulings published before September 13, 1976.

Now, that was obviously the problem for the realtors. Their revenue ruling, which treated some real estate salespeople as employees, was published shortly before the September 13 effective date of the conference report.

Senator BYRD. That is the ruling that you changed today?

Mr. SAMUELS. Yes, sir.

Senator BYRD. Why did it take you almost 2 years to comply with the conference report?

Mr. SAMUELS. We were complying with it, sir. The revenue ruling was published before the conference report. The Service read the conference report as saying do not apply any changed position after this date—the date of the report—which was Septemebr 13, 1976. Now, I do not have the exact date the rulings were published by the real estate people, but I believe that it was in April of 1976.

Senator BYRD. What I am getting at is why did it take you 2 years to revoke that ruling?

Mr. SAMUELS. There is not an easy answer to that question. We have been meeting with representatives of the industry——

Senator BYRD. I know, but you say that the conference report is perfectly clear. It is a mandate.

Mr. SAMUELS. It is a mandate——

Senator BYRD. And yet it has taken you 2 years to comply with the mandate.

Mr. SAMUELS. No, sir. Let me try to make it clear again.

The conference report said do not apply any changed position or any position inconsistent with a revenue ruling that is outstanding on this date, and that was September of 1976. So after that date, do not publish any new rulings.

We did not do that. We have not done that. The real estate ruling was published earlier in 1976 and was already on the books when the Congress requested the Service to not change any position.

So the realtors were in the unfortunate situation of having had a new ruling published shortly before the Congress acted, or made its request, in the conference report.

So they were really technically not covered by the conference report.

Senator BYRD. Technically not covered, but it seems pretty obvious what the Congress had in mind, did it not?

Mr. SAMUELS. Well, they said do not change your position——

Senator BYRD. Well, then, let me ask you this question. Why did you change your ruling today then that you had adhered to for 2 years?

Mr. SAMUELS. Well, we think on reflection that it is wrong to apply those 1976 rulings to past years as opposed to future years.

Senator BYRD. That is a very good statement.

Mr. SAMUELS. And that is why. We are changing it for that reason. We think it is incorrect.

Now, what we are saying is that we are going to publish a new revenue ruling with an effective date of January 1, 1979 and up until that date, the law that the realtors had been operating under for a number of years will continue to be the law.

Senator CURTIS. Mr. Chairman?

Senator BYRD. Senator Curtis.

Senator CURTIS. I think I have a pretty good idea of what the Congress intended when it wrote that language. What we intended was not to put a hold order on new regulations, but to put a hold order on your treatment of individual taxpayers.

I do not think anybody could read it any differently. We did not just write a mandate in the conference report that said you should not make any new regulations. We suspended your action and proceedings against these people until the joint committee staff brought in an answer to these questions.

Now, we concede that there might, here and there, be a situation of an employer seeking to avoid social security taxes. Those are special cases and we have ample law on fraud and deception to take care of that.

Now, if individual citizens enter into a contractual relationship where one is a wholesaler and the other is a retailer, or one is an independent contractor and they act on that belief for all purposes over a period of years, should not that definition of their operation prevail for tax purposes?

Mr. SAMUELS. That has not been the position of the tax law in the past. If the Congress wants to allow employer and employee to elect how they should pay their taxes——

Senator CURTIS. No, no, no. You are stating it wrong. You are stating that they should allow employers and employees to determine by agreement how they should be treated. They are not seeking an election. These people have never been treated as employees. They are citizens entering into a business arrangement, nor for the purpose of affecting their tax liability, but for all purposes of operation, and have done so over a period of years.

Is that not the arrangement that the tax law should be applied to?

Mr. SAMUELS. Are you asking for prospective years now?

Senator CURTIS. I am asking for the year of Adam, on down to 1980.

Mr. SAMUELS. That has not been the interpretation applied to the tax law by the Congress or the courts or the Internal Revenue Service in the past. There is an objective standard, which is in this relationship an employer-employee relationship regardless of how treated by the individuals involved. And even though they have treated it consistently as an independent contractor relationship, if it clearly is not—and I think very little is clear in this area—the courts have consistently held the relationship to be that of employer-employee.

I might add that this is not a one-way street. There are a number of payees—I will not call them employees—but persons who want to be treated as employees. They have written to the Treasury. They want to know why we are not aggressively treating them as employees or making sure that their employers do.

Now, we have not been changing any rules since the 1976 Act. We think part of the problem—and it is part of the great difficulty that a number of the representatives on the panel have indicated to the Treasury in prior meetings—is that they do not really care how income taxes and social security taxes are collected for future years—now I am not talking about the past—but they are concerned about matters such as unemployment compensation, collective bargaining, that if you begin to call someone an employee, there are a number of ancillary or collateral effects which follow which are not desirable to them.

We are very sensitive to that issue and hope to address it in our overall legislative solution in defining when taxes should be withheld and when they should not be.

Senator CURTIS. Now, I have a request in reference to this language in the conference report. I would like to have you submit for the record all directions, bulletins, letters, communications, regulations and so on that were sent out, either by the Treasury or the IRS to all IRS offices and employees instructing them to follow the language of the conference report.

If there are no such communications, I want you to so state in the record, but if there are any, I want complete copies of every one of them.

Mr. SAMUELS. I will check with the Internal Revenue Service.[1]

Senator BYRD. Senator Dole?

Senator DOLE. My questions have been covered. I note that the Treasury opposes S. 3007 because it would interfere with the orderly administration of the tax laws.

With reference to S. 3037, you have revoked ruling 76-136 and 76-137. You state in your testimony:

> The new ruling will reinstate the rules contained in Treasury Mimeograph 6566 with respect to the employment status of real estate salespeople for all periods prior to January 1, 1979.

Now, that is the position of the Treasury?

Mr. SAMUELS. Yes, it is, Senator. We have not yet revoked that ruling, but a ruling will be published shortly—very shortly—that will revoke both of those rulings and reinstate the GCM which represents prior law in this area which will, I think, affect a number of pending IRS examinations.

Senator DOLE. Do you have anything in mind for the others?

Mr. SAMUELS. Well, we think that the—no, we do not. We think that the real estate industry—the revenue rulings issued with respect to the realtors, on reflection, probably should not have been applied retroactively when they were issued. When they were issued, they applied to years prior to 1976—1975, 1974 and 1973, which might have been open years. On reflection, that probably should not have been the case. They represented what could fairly be characterized as a change in position with respect to real estate salespeople.

Since that was not done, we think it is now appropriate to apply what we believe to be the correct interpretation of the common law to prospective periods, and the revenue ruling that will be published with respect to that will apply only to employment tax quarters after January 1, 1979.

Now, with respect to S. 3007, we looked at all regulations and rulings published since this January 1, 1976 and found these two to be the only ones that were controversial. We hoped that, in taking this action with respect to the real estate salespeople, we would deal with the underlying concern contained both in S. 3007 and S. 3037.

Mr. LIBIN. Senator, may I say something with respect to the situation in the insurance industry, because I think there is some confusion here.

All of the pertinent published IRS rulings with respect to the commission of insurance agents treated them as independent contractors. The companies relied on those rulings.

The most recent published ruling was 1969. At that time, and shortly thereafter, the Service began its new audit program which completely reversed is position with respect to the treatment of commissioned insurance agents.

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[1] See p. 220.

There have been no new published rulings one way or the other, but everything that has been published in the insurance industry points toward independent contractor treatment, and it was only by virtue of the new audit program that insurance companies began to realize that they were going to have the position changed.

I think it is somewhat misleading to say that, well, the only rulings that we issued that we think we have to evoke that apply prospectively deal with the real estate industry. The whole problem is the change of audit procedures.

Mr. OFFEN. Senator, that is exactly the same position that the direct selling industry is in. We do not have any adverse revenue rulings. We just have a departure, which the Court of Claims called a radical departure, from the common law test through the application of new audit practices and procedures that we also track back to approximately 1970.

In addition, I would like to comment that Mr. Samuels, in his presentation on withholding and social security indicated that it might not be that much of a changed condition. If our industry is any indication—Robert Nathan, our economist, says that even simple withholding would cost our industry $70 million a year and would net, at the most, for the Treasury $19 million.

Senator DOLE. Well, I would like to settle it right now, if we could. We want to make a record. I know Mr. Samuels is in a difficult spot because he probably does not speak without going through channels—or maybe you could, if you wanted to.

Mr. SAMUELS. Well, I can, but it would not be authorized, so you would not want to hear it.

Mr. FARRER. Senator, the realtors are grateful for the action taken by the Treasury Department and also we would reinforce the fact that we have relied on an eighth circuit opinion that was almost 30 years old. In fact, we even have publications to help our people understand the relationship of the independent contractor and to give them a choice as to whether they want to operate their firms on an employer-employee relationship or an independent contractor relationship.

And so it is based on these guidelines that our people are knowledgeable, and that is our great concern, whenever these huge assessments come rolling in against our people, contrary to these established guidelines.

Senator DOLE. Well, as I think you have indicated, you have been working on this for some time. Is there a chance we might have some suggested legislation in the very near future?

Mr. SAMUELS. Yes; indeed. A task force has been set up in the Ways and Means Committee, chaired by Congressman Rangel, to study this issue. It, obviously, will be considered carefully there, as well as carefully on the Senate side. It is a highly complex issue, as you can ascertain from the statement of the panelists today. It involves many, many millions of dollars and many business relationships and I would think it is only after full public hearings that the Congress would want to consider a legislative proposal.

and hope to have a proposed legislative solution shortly.

But we are working with the Justice Department and the Service

Senator DOLE. Right. I would not think in the meantime Treasury would object if we just stopped everything. We are going to adjourn sometime this year so maybe we should tack on a little amendment to help the Treasury.

Mr. FARRER. The Senator is correct. There is really only 5½ months left until January 1, 1979, and then, of course, we do not know how that is going to effect, or what kind of new ruling that the Internal Revenue Service will bring to it.

Senator DOLE. We certainly do not want the Government to move too quickly.

Mr. SAMUELS. We are making every effort not to apply new positions to past years, but I think it is very difficult to stop collecting or enforcing the withholding provisions of the tax law and the collection of social security funds and that is the difficult position the service finds itself in. It has to administer what is becoming an increasingly unadministerable law.

Now, I would like to point out with respect to the changed audit positions that a number of panelists have addressed themselves to, that what has happened, I think, is the Service has increased its audit activity in this area because of the realization of the growing importance of employment taxes in our tax system. And it is just the number of taxpayers who are being audited has increased. It is not any change in position. The standard has always been who is an employee under the common law.

Now, there are some 20 factors that apply to try to decide who an employee is and who he is not. But for years prior to the 1970's I think an employment tax audit generally involved going in and checking the employer's arithmetic and if the arithmetic was right, there was no question as to status.

But I think it is this increased activity rather than any change in substantive position that has generated so much concern.

Mr. LIBIN. Senator, I do not wish to prolong this debate, but I just must respond to that, because the Nebraska companies I represent received a private technical advice memorandum from the National Office of the Internal Revenue Service in 1971 stating that their commissioned insurance agents; or a portion of them, at least, were independent contractors—the only ones affected by the technical advice memorandum.

In June of this year, the companies received an audit report from the Internal Revenue Service proposing an assessment of some $10 million. The report included the year 1971 and took a position that was flatly contrary to the private technical advice memorandum in 1971.

So, to suggest that it is merely a case of increased audit activity, I think, is not the whole story.

Mr. OFFEN. We also have had the situation where private letters have been reversed, and the Service has actually said that anything over 7 years old will no longer be considered valid. They told that to Queensway Fashions and Beeline Fashions.

Senator BYRD. Would the Senator from Kansas yield at that point?

Senator DOLE. I would be happy to yield.

Senator BYRD. May I ask Treasury about that memorandum that goes back to 1971. Is that a customary procedure, when rules are changed, to go back on the taxpayer for a period of time such as that?

Mr. SAMUELS. No, Senator, but I think what is customary is that every audit, by its very nature, is retroactive. In other words, you cannot say to taxpayers, don't report your income—just for example—until you are caught, and then if you are caught, we will make you report it for the future.

The audit process is, by its nature, retroactive and has to be. The statute of limitations is generally 3 years, and so if the Service, for example, determines that the relationship should be employer-employee rather than payor-independent contractor and that relationship was the same for the year of the examination and 2 preceding years, or 3 preceding years, where the statute of limitations is open, they will assess the tax for each of those years, and that is not anything peculiar to the employment tax area. It is just in the nature of tax audits.

Senator BYRD. How do you go back 7 years?

Mr. SAMUELS. Well, frequently taxpayers will execute waivers of the statute of limitations for other issues, or perhaps this issue, and agree to keep the year open, either because the Service has not been able to conduct its audit or the taxpayer is suing for a refund of income taxes. There is an opportunity for an agreement between the Government and the taxpayer to extend the statute of limitations. That is consensual.

Senator BYRD. Senator Laxalt?

Senator LAXALT. I have no questions.

Senator BYRD. Senator Packwood?

Senator PACKWOOD. I have no questions, Mr. Chairman.

Senator BYRD. Before calling on the next panel, I would like to make a brief statement.

Senator Packwood has agreed to Chair these hearings until 12:30. I must go to a meeting with a Member of the House of Representatives to try to iron out some differences between the House and the Senate on the military authorization legislation. Senator Packwood has commitments after 12:30 and so does the Senator from Virginia.

If we are not able to conclude the ambitious undertaking of handling 15 bills today, Senator Packwood, if you feel that when the hour of 12:30 arrives and you have to leave, if you feel it would be useful, I would suggest that you recess until 8:30 tomorrow morning, and I could preside over this subcommittee until the Finance Committee meets at 10. That way we could hear those witnesses whom we have not been able to hear up to that point.

Thank you very much.

Then next panel will be a panel of two, Mr. Robert Neville representing National Restaurant Association, accompanied by Albert McDermott, American Hotel and Motel Association; and Mr. Robert Juliano, Hotel and Restaurant Employees and Bartenders International Union to discuss S. 1674.

Welcome, gentlemen.

Gentlemen, go ahead.

STATEMENT OF ROBERT NEVILLE, NATIONAL RESTAURANT ASSOCIATION, ACCOMPANIED BY ALBERT McDERMOTT, AMERICAN HOTEL AND MOTEL ASSOCIATION

Mr. NEVILLE. Mr. Chairman and members of the subcommittee, I am Robert Neville, Counsel for the National Restaurant Association. We appreciate the opportunity to appear before your committee today in support of S. 1674, cosponsored by Senators Laxalt, Cannon, Curtis and Dole.

Joining us in this testimony, and with me here, is Mr. Albert McDermott, the Washington representative for the American Hotel and Motel Association and Mr. Douglas Bennett, the National Restaurant Association's special counsel on tax matters.

Senator PACKWOOD. Would you pull that microphone a little closer? They cannot hear you in the back.

Mr. NEVILLE. Yes, sir.

With your permission, sir, I will make a summary of the statement and count on the full statement's appearing in the record.

In 1965, section 6053 of the Tax Code was added to the Internal Revenue Code requiring employees to report to their employers all tips received on their own behalf by the 10th day after the month in which they were received. Prior to this time, the employer had no responsibilities for reporting tip income.

This income is subject to income tax and social security withholding and is reported on the employee's W-2 form. Section 6051 of the code, however, specifically provides that the employer include on the W-2 forms only those tips which are reported by the employee. This process has been carefully followed by employers and employees in the hotel, motel and restaurant industries since 1965.

Then in 1975, without any change in the law, IRS issued a ruling requiring the employer to keep a record of all charged tips—tips added on a credit card—and to report the sum total of those charged tips on that employee's W-2 form, regardless of the amount of those tips the employee had reported to his employer.

Arrangements for tip splitting with busboys or tip pooling with other waiters and waitresses are common. Yet, this ruling ignores this fact and would require the employer to report the total charged tip turned over to the employee, regardless of the ultimate recipient, even though, under the law, a tip or a portion thereof is income only to the ultimate recipient.

Hence there would often be a difference in the amount reported by the employer and the amount actually received by the employee, and the employee would be required to explain and justify that difference in an attachment to his own income tax return.

Senator PACKWOOD. Let me make sure I understand what you are saying. When the employee reports to the employer the amount of tip, whether it is the busboy, chef, waiter—

Mr. NEVILLE. Yes, sir.

Senator PACKWOOD. And so you know exactly what they are reporting, which goes on a W-2 form.

Mr. NEVILLE. Yes, sir.

Senator PACKWOOD. But the amount that goes on the credit card, is that automatically allocated to the waiter or waitress? Is that the presumption?

Mr. NEVILLE. That would be true under the IRS ruling 76–231 which this legislation would nullify; yes, sir.

Thus, in effect, the ruling requires the employer to knowingly make a false report of the income of many of his employees. In 1976, the Senate adopted a provision repealing this IRS ruling, but since the House had not considered the issue, the Senate-House conferees on the Tax Reform Act of 1976 agreed to drop the provision, but to postpone the effective date until January 1, 1979.

Mr. Chairman, the problems that arise from this ruling can be very briefly summarized. It conflicts with the basic statute and the intent of Congress.

Two, it would impose a new and extensive recordkeeping and reporting burden on employees and employers.

Three, while the employer may possess records on the total amount of the charged tips, he will not have any clear mechanism for breaking down the total on an employee-by-employee basis because of tip splitting and tip pooling arrangements.

Four, it would unjustifiably impugn the honesty of many thousands of tipped employees.

Five, employees would be burdened with the requirement of denying and explaining nonreceipt of income reported by the employer on form W–2.

Six, it would create a continuous source of conflict between the employer and his employees.

Seven, it would require, in many instances, that the employer falsely report the income received by his employees.

Senator PACKWOOD. When you have tip pooling, is that an arrangement solely among the employees? Does the employer have anything to do with it and does he know how it is split?

Mr. NEVILLE. The employer can enter into an arrangement to establish such a pooling arrangement, but is also done frequently by employees on a voluntary basis.

Senator LAXALT. Do not most employees religiously avoid being involved in a very troublesome internal problem?

Mr. NEVILLE. They do, indeed, Senator.

Mr. ALBERT MCDERMOTT. Senator, the recent amendments of the Fair Labor Standards Act made it pretty clear—abundantly clear—that tips are the property of the employee and the employer really gets into that area at his peril.

Mr. NEVILLE. Mr. Juliano will deliver the rest of our statement.

Bob, go ahead.

Mr. JULIANO. I would ask that our statement be submitted for the record and I will briefly summarize.

Senator PACKWOOD. All of the statements will be inserted in the record.

Mr. JULIANO. Thank you.

STATEMENT OF ROBERT JULIANO, HOTEL AND RESTAURANT EMPLOYEES AND BARTENDERS INTERNATIONAL UNION

Mr. JULIANO. On behalf of our general president, Edward T. Hanley, it is a pleasure to appear before your subcommittee to support S. 1674, a bill changing the recordkeeping requirements applicable to employers with respect to tip income of their employees.

Mr. Chairman, we feel that the facts are simple and clear. The subject of declaration of tip income has been the same since 1976. The revenue ruling obviously does not take into account the existing law and reflects a clear lack of understanding of our industry.

Your committee wisely adopted a clarifying amendment on May 27, 1976. We appear here today on behalf of all of our gratuity employees, and all of our workers affected by this matter, and urge strongly that the committee report this bill.

The previous IRS Commissioner indicated that the implementation of this revenue ruling would mean a gain of $5 million to the Treasury. Subsequent testimony on his part and the newer form of higher mathematics which we get to figure out which one they used, raised that figure to about $100 million.

As our written testimony states, and, we feel, proves, our members are still low-income and middle-income wage earners. The IRS would have you believe that our members are among the wealthiest in the country, and this is simply not true.

In the past 2 years since the conference committee adopted this report, the IRS has not provided any rationale or data to support its proposals. If revenue ruling 75–400 which was superseded in May 1976 by revenue ruling 76–231 had been implemented, major problems would have arisen.

In fact, one of the more prominent that occurred said that in most of our cities where collective-bargaining agreements have a checkoff system providing for automatic payments of dues, our members receive minimal paychecks and, in some cases, blank payroll checks.

Management then told the union to go ahead and collect the dues themselves, so the IRS, with this ruling, abrogated duly negotiated collective-bargaining agreements which were arrived at under the auspices of the Taft-Hartley Act.

In 1965, Congress thoroughly examined the reporting requirements and methods of taxing income from tips received by employees. It is apparent from the legislative history that Congress was fully aware of the practices and customs of tipped employees and was deeply concerned that employers reporting and recordkeeping requirements be minimal. This system has been in effect for over 10 years and there has been no showing of abuse or problems under it.

I, therefore, respectfully urge that the Congress confirm its 1965 judgment and permanently repeal the IRS rulings, for simple equity supports the retention of the spirit of the actions of Congress over 10 years ago.

Thank you, Mr. Chairman.

Senator PACKWOOD. Yes, sir.

Mr. ALBERT McDERMOTT. I represent the American Hotel and Motel Association, and the statement that Mr. Neville read to the committee is a joint statement on behalf of our two associations.

Senator PACKWOOD. The record will show that.

Mr. ALBERT McDERMOTT. Thank you.

Senator PACKWOOD. Gentlemen, I have no questions. This is relatively speaking, a very simple and clear issue. It is not hard to understand, and you have made a good presentation. I appreciate it.

Mr. NEVILLE. Thank you.

Senator LAXALT. I would like leave, first, Mr. Chairman, to file a full and complete statement relating to that in the record.

Senator PACKWOOD. It will appear just before the statement of the witnesses.

Senator LAXALT. If Treasury would like to speak to this first, they would be welcome.

Mr. SAMUELS. Fine, Senator.

The Treasury does oppose this bill. Failure to report income from tips is a chronic and consistent compliance problem. Two studies that are being completed now by the IRS indicated that, in one case, only 15 percent of tip income is reported; in another, only 30 percent of tip income. This large, continued tax avoidance diminishes public respect for our tax system; could jeopardize voluntary compliance; and is patently unfair to those taxpayers who must pay a larger share of the tax burden because of this noncompliance.

We think the revenues involved here are quite substantial. I saw a sheet which was passed out indicating what the revenue estimates were. They have been prepared by the joint committee staff, I believe. We have not yet had our estimates prepared, but I note that last year when—or I guess 2 years ago—when then-Commissioner Alexander testified, he stated that the amount of revenues involved were about $100 million a year, and I think that is a ballpark figure that is probable accurate.

Now, what the Service is asking the restaurant owners to do is really nothing different than they ask any other employer to do. We are not talking about cash tips that you leave on the table for the waiter, but a charge account tip, which you sign on your American Express bill or Master Charge or whatever; we are asking for an information report—what happens is the waiter takes that charge slip and he generally, at the end of the night our studies show, gets reimbursed from the cash register. Sometimes he gets it at the end of each meal, but usually they are so busy that the end of the night there is a total made and he turns in his copies of the charges slip to the cashier and the cashier then pays the waiter the amount of his tips.

What we have asked restaurant owners to do is—if the amount of those tips that they pay exceeds $600 a year—file an information statement with respect to those tips—it is essentially a 1099. It goes on the W-2.

They say, well, we cannot do that because it is too burdensome, and these are two burdens that they identify. One is, they say, we do not keep records per individual employee of charge tips.

Now, generally we do not believe that that is true, at least on a daily basis. At the end of the night they have to know which waiter had which slip and pay them out, and at that time, there is a settling up, and so for business reasons they have that record. Now, they may not keep that record for more than a day or so, but there is no real reason for them not to keep that record.

They do know the aggregate amount of charged tips, because when they get the money in from American Express it is going to have not only the money for the meal but the money for the tip. They will have paid out the money for the tip, and they have to know how much of that coming in from American Express is really their income.

So we believe that most restaurants now have, at least on a daily basis, a record of how much in charge tips they pay over per employee and, if they do not, all that is involved would be a simple notation on the charge slip of the employee's initial when you pay it over to him.

Now, the examining agents of the Internal Revenue Service have determined since that revenue ruling was published and then suspended by the Congress, a number of larger restaurants have already adapted their payroll system so there will be no additional burden in keeping track of which employee gets a charge account tip, and how much, for reporting purposes.

Indeed, several of the largest have computerized payroll systems and have reprogramed their computers. Now, the smaller restaurants, the mom and pop restaurants, the roadside diners, obviously do not have that capability, but I think, similarly, they do not have a significant amount of charge account business—or, at least, not as much as the higher priced restaurants do.

So, we really do not think it is a significant burden to ask restaurant owners and hotel owners to break out the amount of charge account tips paid per employee when they already have the record—when in many cases they already do that, and they certainly have the record of total charge accounts tips.

Now, the other problem the industry points to with requiring charge account tips to be reported as income to the employee is tip splitting or tip pooling arrangement. They say, well, all of this tip may not be the entire income of this employee because he may split some with the busboy or, if it is a tip splitting or tip pooling arrangement, with other waiters or waitresses, and that is true.

But there are two points I would like to make about that. One, that is not unique to the restaurant industry. The Internal Revenue Code now requires any person making payments to any other person of more than $600 per year to file an information statement. Now, we are not entirely sure that that what is reported on the information statement is all income. What you do is when you file your tax return you reconcile the difference between that amount and your expenses.

I mean, if you have a plumber in to fix the plumbing in your business premises and you pay him $1,000, you are under an obligation to file an information report. Similarly, if you pay your lawyer in private practice—if a major corporation makes a payment to an attorney—they have to file with the IRS a form 1099 miscellaneous indicating the amount of that payment.

Now, to be sure, that entire payment is not all income to the lawyer. He has a lot of expenses, and he shows that when he files his income tax return.

So, the employee could very easily reconcile the difference between the amount of the gross payment and the amount he paid out in tips or other expenses to other persons on his tax return. His employer would never see it.

If, however, that is too much of burden to the employee, the IRS is prepared to revise the forms on which the employee reports each month to the employer the amount of tips he received to show how much he has paid out in tip splitting or tip pooling; in other words, how much he has actually kept, so that when the employer files the form 1099—it is not really a 1099; when you are paying wages, it is just another box on the form W-2—there would be no reporting of charge account tips that exceeded the net amount that was income to the employee.

Either way, the problem is solved, and we would be delighted to work with the industry to see which way they prefer it. It is to make this problem of not having an information report for the employee that exceeds the amount that is actually the income of the employee.

Again, this is a burden that is not imposed strictly on the restaurant industry. Their problems are not unique in this respect, and we really do not think they are significant administrative problems, particularly since the records are kept by the large establishments that use credit cards already and the revenues involved, we believe, are substantial.

Equally important, the public percept of the fairness of our tax system is at stake here. We think this bill is really an open invitation to employees to not report charge account tip income. It says the employer does not have to keep any records on a per employee basis and what you are left with, then, are individual audits of employees which are very difficult for the IRS. It is very difficult to flush out income that has been concealed or used as living expenses. Particularly in the case of employees who are itinerant by nature, which many restaurant and hotel employees are. There is a high turnover in that industry.

It would be an ineffective method of collecting tax, and we really do not see why we should isolate the restaurant industry and say the reporting requirements for you should be more lax than any other business.

Mr. JULIANO. I would like to thank the Treasury Department for really presenting items which substantiate what our testimony is trying to reflect.

We really could have just changed the date of what they are saying—and I have to commend them for their consistency. The original one was under a prior administration. Now we have a new Commissioner and their attitude is still the same—obviously, my members are crooks, and everyone knows that. You are not talking about low-income works, you are talking, obviously, about people who are very wealthy.

They are taking into account the problems of the industry, they say. We are flooded with a turnover of 150 to 200 percent. I could see a waiter of ours at night trying to reconcile what he received in tips with the busboy, with the chefs, with the bartender—we are plagued, consistently, with the chronic problem of illegal aliens, which also plagues the employers, and it is very prevalent in our industry because it is more conducive to the low-income workers.

Senator LAXALT. Essentially, are we not talking, Mr. Juliano, about the fact that we are attempting to make the employers policemen in this situation?

Mr. JULIANO. Collection agents and auditors for the Internal Revenue Service.

Senator LAXALT. I think, theoretically, that should be the job of the IRS. This is slipping through the cracks. The IRS has adequate means for conducting audits—as they do in my State all the time——

Mr. SAMUELS. Senator, if I may interrupt, all we are asking for is an information return, which we ask for on every other person who receives payments, to help us with the audit.

Senator LAXALT. But when you get to the point where you attribute the tip income to a given employee, you are making cops out of them, because you are always going to have pooling and splitting arrangements as we do in most of our hotels.

Mr. JULIANO. That is correct.

Senator LAXALT. I might say to the Treasury, if you do not know already, that this is one of the most vexing management problems that there are in major hotels in this country, and that is the matter of just how you handle tips to begin with, separate and aside from reporting requirements to the Government.

Traditionally, I think in most of the places, it is hands-off policy. Is that correct, gentlemen?

Mr. JULIANO. That is correct, Senator.

Senator LAXALT. And it is handled purely by the employees.

Mr. ALBERT MCDERMOTT. That is by law, Senator. That is written in the Fair Labor Standards Act.

Mr. SAMUELS. We are not asking to get involved in that. All we are asking——

Senator LAXALT. I think you are, necessarily. I think if you are going to require these people to report and make the allocation, that is bottom line, is it not?

Mr. SAMUELS. But that necessarily does not have to go to the employer, Senator. In other words, all we are asking is the employer to file a statement. I paid out of my cash register to this person more than $600 this year.

Mr. ALBERT MCDERMOTT. But there is a specific provision in the code that relates to tipped employees, and that is what they are trying to get around.

Senator LAXALT. Explore that for the record, will you? That point? It is rather important, the point that you just made, the provision in the code.

Mr. ALBERT MCDERMOTT. That is our prepared statement.

Mr. SAMUELS. I can explore it. I am familiar with it.

Mr. ALBERT MCDERMOTT. Section 6053, in 1965 was put into the law, and that dealt solely with tipped employees and now IRS says it is not happy because they have not, they say, been able to enforce it properly, so they want to go to another section of the law that applies to all businesses. But section 6053 is a specific reference to the tipped employees.

I would like to say that we represent small business and the gentleman from the Treasury talked about big business. We can always take one example—and that is what he is taking, an example or two about in this day and age we are merchandizing, and it is easier, perhaps, in some instances, for a large organization to handle this. But that small businessman or small businesswoman who runs the inn and he is on the desk and his wife or daughter or son or somebody in the family is running the restaurant, and the wife is the hostess, as is oftentimes the case, and the cashier and then to put this extra burden on her is too much for this small business.

Mr. JULIANO. We think it is a classic example of an executive agency trying to write legislative act. In 1966, the Fair Labor Standards Act is very clear. Treasury's contention and the Service's is we do not want to hear about that. That is another agency of Government.

We say, fine, except that it is also one that covers my people. The law have been very clear since 1966 on what constitutes to tipped employee and what the reporting requirements are. They have had a number of opportunities to change it, including in the interim period from the time we last came before your committee and you adopted a clarifying amendment, last October, when the law was amended, the Fair Labor Standards Act, and they did nothing about it.

We approached the Congress with the onset of a new administration and we were asked by sponsors in both the Senate and the House in accord with us that we should be very statesmanlike and give the new administration an opportunity to assess the ruling and wait until the administration appointed a new Commissioner, which we all did.

Once the new Commissioner was appointed, we jointly sent in letters to the new Commissioner in September of 1977 indicating what our position was and thinking that perhaps, you know, after review they might want to feel that this area was not as important as the previous administration.

Eight months later we received a written reply thanking us for our letter and 2 weeks after that we were summoned to a meeting. So for acting very statesmanlike we are now in a bind because this is one area of the Tax Reform Act of 1976 which really had an imposed moratorium on it of January 1 of 1979. And I do not know if their intention is that obvious, but we are running out of time on the legislative calendar in an area that, really, the only reason why the House objected the last time, as many of you recall because you were conferees, was simply not on the merits of the issue but the fact that the House had not had a chance to deliberate the issue because they reported the bill out when the Service came out with the revenue ruling.

I must also add that tomorrow a bill is going to be dropped in in the House Ways and Means Committee which is a companion bill to the bill we are presenting here that Senator Laxalt introduced and Senator Cannon and Senator Curtis, and cosponsor Senator Dole, and it is going to be—Congressmen Rostenkowski, Vander Jagt, Waggonner, Conable and Cotter amendment or bill and depending on how the tax bill goes there, it will be the same bill as you people have introduced here, which we think shows a great deal of unanimity.

Senator CURTIS. Mr. Samuels, the informational return under existing law applies to any taxpayer that pays out to someone else $600 or more?

Mr. SAMUELS. That is correct, generally, Senator, yes.

Senator CURTIS. So, if I paid my dentist more than $600——

Mr. SAMUELS. No; it has to be a payment made—that is why I said generally—you have to be in the course of a trade or business. In other words, if you pay your milkman more than $600 a year, you do not have to file a return.

Senator CURTIS. Now, are there any other instances that an information return has to be filled because a third party made a payment?

Mr. SAMUELS. That is the difference, and that is why I would like to explore what the revenue rulings the Service published did.

Senator CURTIS. The statute requires an information return, requires it from the person who makes the payment.

Mr. SAMUELS. That is correct.

Senator CURTIS. Did you have any addition to that statute when you took your position in reference to tips?

Mr. SAMUELS. Let me explain what the problem, I think, is that the industry has, and that is when you go into a restaurant and leave cash on the table, and then the waiter puts it in his pocket, there is no way for the employer to know how much that tip was to file an information report. So, the Congress said, all right, what we are going to do is we are going to have the employee each month tell his employer how much cash he got in tips.

In that way, the employer will know how much to report each year as tips to that employee. It is the only way the employer can know with respect to cash tips.

That is section 6053 of the code.

Now, there is another provision in the code that says any person engaged in a trade or business who makes payments of salary, wages, et cetera, et cetera, aggregating more than $600 a year has to file essentially an information report with the Service giving the name of the person to whom he made the payment and the amount.

Now, that—on a charge account tip, that is different than a tip that is left by the customer by the table, or the patron on the table, because there there is a cash payment from the owner of the restaurant to the waiter. The waiter presents the charge account slip, usually at the end of the night, and collects all of his cash tips. And with respect to those payments, the Service issued a revenue ruling that said the general provision dealing with payments of more than $600 a month applies to those.

The industry went to court and challenged that ruling saying that the provisions dealing with tip income are exclusive and you cannot take this other section and graft it on top of the provisions dealing exclusively with tip income, and they lost. The court said no, that ruling is not in conflict with the code, but rather is consistent with the code.

All we are talking about here are information reports on charge account tips where the payments are made from the restaurant owner to the employee and whether those, if those exceed more than $600 a year, whether a simple information report has to be filed.

Senator CURTIS. Well, my question is this. Perhaps maybe the Congress has some responsibility here—I am sure they have—has the idea that you must report a payment made by somebody else been applied to anybody except restaurant owners?

Mr. SAMUELS. I hesitate to answer that because I am not sure I am familiar with all of the information reporting requirements. Generally, the requirement is imposed on the payor and that is all we are asking for here.

I think, in the case of waiters——

Senator CURTIS. You mean the restaurant owner pays the tip?

Mr. SAMUELS. No; the restaurant owner does not—he actually pays the cash.

Senator CURTIS. But he is a conduit, not the payor.

Mr. SAMUELS. Oh, yes; then there are many information reporting requirements imposed on payors. Merill Lynch is holding stock as a nominee. It has to file information reports on who it pays the dividends to.

Senator CURTIS. No; but he is acting for——

Mr. SAMUELS. He is acting for the owner of the stock.

Senator CURTIS. He is acting for his customer.

Mr. SAMUELS. Well, there are a number of information—a trustee—there are a number of other cases. I did not understand the thrust of your question.

Senator CURTIS. I am just questioning the relationship.

Mr. SAMUELS. Principal agent relationship. I think anybody who makes the payment is picked up by the code. I think there are a number of other examples.

Mr. ALBERT MCDERMOTT. May I just correct the record in one instance, Mr. Chairman?

I think it was stated that back in 1965 when Congress did enact this section 6053, they were talking about cash tips. But the Congress at that time was cognizant that there were charge tips in existence in 1965, and the remedy to handle this tip income provision which was section 6053 included both the charged tip and the cash tip, and the Congress made itself clear at that time.

Senator PACKWOOD. Senator Laxalt?

Senator LAXALT. No questions.

Senator PACKWOOD. Bob, you had a question?

Senator DOLE. We have about 20 witnesses left, I just want to highlight the points in the testimony about all the extra recordkeeping there are 1.3 million tipped employees. If you have to report everyday, you are going to have a lot of paperwork. I think the record has been fairly well made.

This bill is like the Fannin amendment adopted in 1976. As you correctly stated today the House did have hearings. It would seem if there is this movement on the House side by the very responsible influential Members there that you mentioned, the attitude must prevail that something must be done, and it must be something this year.

Senator PACKWOOD. Gentleman, thank you very much.

[The prepared statements of Senator Laxalt and the preceding panel follow:]

STATEMENT BY SENATOR PAUL LAXALT ON S. 1674

Mr. Chairman, as you know, since 1965 employees have been required to report to their employers all tips received and retained after any tip pooling or splitting arrangement. But employers are only required to pass through the information received from the employee to the Internal Revenue Service.

In 1976, however, the Internal Revenue Service attempted to change all that. Revenue Ruling 76-231 held that all charge account tips, whether or not reported by the employee, must be reported to the Internal Revenue Service by the employer. The employer's information reporting was to be used as a check against the amount reported by the employee on his income tax return. In the event that that amount differed from the total amount of tips reported by the employer, the employee would be required to explain the difference in an attachment to his own income tax return.

There are a number of problems occasioned by this IRS Ruling. Certainly additional and burdensome record-keeping requirements figure prominently among these. The principal problem, however, is that because of the splitting and tip pooling arrangements the employer, although possessing records of the total amount of charge tips, will not have any clear mechanism for breaking down the total on a per-employee basis.

In 1976 the Finance Committee found that the procedure by which employers merely passed through information received from employees in reporting the employees' tips to the Internal Revenue Service was entirely appropriate, and thus nullified IRS 76-231. Under the Finance Committee version of H.R. 10612, the Tax Reform Act which subsequently passed the Senate, the only employee tips which the employer would have to report are those tips reported to the employer by the employee under present law. Also employers would not have to be required to maintain a running tabulation of the allocation of total charge account tips to any particular employee. The only records which employers would be required to retain in connection with charge account tips would be the statement of tips as furnished by the employees and the charge account receipts.

Although the Finance Committee provision repealing IRS Revenue Ruling 76-231 passed the Senate, the Conference Committee subsequently agreed to drop the Senate provision nullifying the Ruling. They did, however, postpone its effective date until January 1, 1979, to give the House time to consider it.

On June 10, 1977, I introduced S. 1674, which is identical to the language overturning Revenue Ruling 76-231 which passed the Senate in 1976. And I am happy to say that the House is also seriously considering this matter. It is my understanding that Representatives Vander Jagt, Rostenkowski, Conable and Waggoner—will soon introduce an identical bill to S. 1674, which has widespread support within the Ways and Means Committee. Despite the lateness of the hour, with action underway in both Houses, I look forward to successful completion of action on this matter prior to adjournment.

The problems created in some larger hotels and restaurants by the ruling are certainly easy to visualize. Equally as simple to deduce is the strain that would be thrust upon the employer-employee relationship by the ruling. By forcing the employer to adopt the role of an enforcement arm of the IRS to insure accurate reporting of tax income, an additional relationship is created between the employee and employer, which can damage the working environment.

In essence, S. 1674 merely preserves the status quo by placing the burden of reporting charge card tips on the employees where Congress intended it. Because the employee knows how much he received in tip income, he is the best person to report it and no undue burdens are placed upon him by so doing. The employer is relieved of the paperwork burden that would be created by the ruling. And this is no small matter, since recent studies have estimated the paperwork costs on our private sector to be between $25-$32 billion a year. Labor-management relations between the employer and his employee would also not be exacerbated by the tip income issue.

Our nation's businessmen have enough to do without taking on additional responsibilities for the IRS. S. 1674 relieves the employer of needless paperwork and overrules an unwise IRS ruling by returning the burden of reporting tip income to the employee where it belongs. Mr. Chairman, I certainly hope that we can quickly move to markup on this measure.

Statement of the American Hotel and Motel Association and the National Restaurant Association

Summary of Principal Points

In 1965 Section 6053 was added to the Internal Revenue Code requiring employees to report to their employers all tips received on their own behalf by the 10th day after the month in which they are received. This income is subject to income tax and social security withholding and is reported on the employees' W-2 form. Section 6051, however, specifically provides that the employer include on the W-2 form only those tips which are reported by the employee. This process has been carefully followed by employers and employees in the hotel/motel and restaurant industries.

Then, in 1975 without any change in the law, IRS issued a ruling requiring the employer to keep a record of all charge tips (tips added on a credit card) and to report the sum total of those charge tips on that employee's W–2 form, regardless of the amount of those tips that the employee had reported to his employer. Arrangements for tip splitting with busboys or tip pooling with other waiters and waitresses are common. Yet, this ruling would require the employer to report the total charge tip turned over to the employee, regardless of the ultimate recipient, even though under the law a tip or a portion thereof is income only to the ultimate recipient. Hence, there would often be a difference in the amount reported by the employer and the amount actually received by the employee and the employee would be required to explain and justify that difference in an attachment to his own income tax return.

In 1976 the Senate adopted a provision repealing this IRS ruling, but since the House had not considered the issue, the Senate-House conferees on the Tax Reform Act of 1976 agreed to drop the provision but to postpone the effective date until January 1, 1979. S. 1674 would nullify Revenue Ruling 76–231 and reinforce the intent of Congress in enacting Sections 6053 and 6051.

Problems with the ruling

1. The ruling conflicts with the basic statute and the intent of Congress.
2. It would impose a new and extensive record keeping and reporting burden on employees and employers.
3. While the employer may possess records of the total amount of charged tips, he will not have any clear mechanism for breaking down the total on an employee by employee basis, because of tip splitting and tip pooling arrangements.
4. It would unjustifiably impugn the honesty of many thousands of tipped employees.
5. Employees would be burdened with the requirement of denying and explaining non-receipt of income reported by the employer on Form W–2.
6. It would create a continuous source of conflict between employer and employee.
7. It would require in many instances that the employer falsely report the income received by his employees.

STATEMENT

Mr. Chairman and members of the Subcommittee: The National Restaurant Association and the American Hotel and Motel Association are the principal spokesmen for the food service and hotel-motel industries. We both have the firm support of our large nationwide memberships in urging the enactment of S. 1674.

At the outset it should be noted that the proposed legislation does not bestow any tax benefit on any employer or employee; nor does it free employers from reporting tip income received by their employees. The bill simply states the intent of Congress as reflected by the legislative history of the 1965 amendments to the Internal Revenue Code.

The need for this amendment to the Code arose in this way. Until 1965, employers were not involved in reporting on or withholding taxes related to tip income. Employees were merely required to report their tips and to pay taxes thereon on a calendar year basis. In 1965, however, Congress made employers responsible for including tip income on employees' earnings reports (Form W–2) and for withholding income and social security taxes thereon. The legislative history of the 1965 amendments demonstrates that Congress was well aware that the requirement could create opportunities for conflict between employees and their employer and the record keeping burdens it would place on employers. It sought to minimize to the maximum degree possible both of these problems. It did so in this way.

To alleviate predictable conflicts between employer and employee over the amount of tip income the employee received, Congress placed the burden for that determination squarely on the employee. Considering the pervasive and equitable practice of tip splitting and tip pooling, Congress recognized that the tax burden should fall upon the ultimate recipients of the tip and that they are the only persons who know the amounts of that income.

"Only tips received by an employee on his own behalf and not on behalf of another employee constitute wages. Thus, where employees practice tip splitting, the ultimate recipient of the tip (or portion thereof) is the employee who is receiving the tips as wages. [H.R. Rep. No. 213, 89th Cong. 1st Sess. 219 (1965)]"

With this recognition of the nature of the tipping transaction, Congress resolved the second principal issue of how does the employer determine the amount of tip income on which to report and wtihhold taxes? They concluded that:

"The only equitable way of counting tips * * * [would be] on the basis of actual amounts of tips received and that the only practical way to get this information [would be] to require employees to report their tips to the employer. [H.R. Rep. No. 213, 89th Cong., 2d Sess. 96 (1965)]"

To effect this logical conclusion, Congress added a new section 6053 to the Code which requires employees to report tips received on their own behalf by the 10th day after the month in which they are received. Corresponding changes to the income tax withholding provisions (sections 3401 et sequi), to the social security tax withholding provisions (section 3101 et sequi), and to the general reporting provision (section 6051) of the Internal Revenue Code were adopted. These changes make reporting and withholding of social security and income taxes on tip income "applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a)." Finally, to make the annual statement of income and withholding (Form W-2) consistent with other provisions concerning tip income, section 6051 was amended to provide:

"In the case of tips received by an employee in the course of his employment, the amounts required to be shown * * * *shall include only such tips as are included in statements furnished to the employer pursuant to section 6053(a).*" [Emphasis added.]

Under the Code and the regulations the Form W-2 is the only report of wages, compensation, remuneration, and income paid to employees which the employer is required to make.

For nearly a decade after the enactment of the 1965 amendments, employers followed the procedure required by section 6051 and withheld taxes on and reported only that tip income reported to them by their employees. Then, in 1975, without any change in the law, IRS issued a ruling (Rev. Rul. 75-400) which required the employer to keep a record of all charge tips paid over to an individual employee, and to report the sum total of those charge tips on that employee's Form W-2. This sum total of charge tips was to be reported to IRS whether or not the tips had been reported by the employee and without regard to who ultimately received the tip or portions thereof through tip splitting and pooling arrangements. The National Restaurant Association contested this ruling with IRS without success.

Our contention was and is that the ruling is inconsistent with the plain intent of Congress when it enacted section 6051 of the Code in 1965. The language of section 6051 clearly states the intent of Congress that the amount to be reported as tips on the Form W-2 "shall include only such tips as are included in statements furnished to the employer pursuant to section 6053(a)."

The concern expressed to IRS centered not only on the facts that this new requirement is inconsistent with the plain language of the Code and would impose new burdensome record keeping requirements on employers, but on other considerations as well.

We are deeply concerned that, with the practice to tip splitting and pooling, assigning the entire charge tips to one individual employee requires the employer to knowingly make a false and inaccurate report on the Form W-2, which is a violation of the Code. That such reports will result in conflicts and disputes between the employer and his employees and in an unjustifiable reflection on the honesty of our employees are also disturbing probabilities.

While the Senate Finance Committee was considering an amendment to resolve the matter, IRS issued a new ruling (Rev. Rul. 76-231) which, while more detailed than its predecessor, continues the same burdensome requirement.

The legislative history of the 1965 amendments is abundantly clear that Congress thoroughly understood the practices and customs of tipped employees and was deeply concerned that these amendments not present burdensome accounting problems for employers. The following is a reflection of this concern:

"The employee would be required to report to his employer in writing the amount of tips received and the employer would report employees' tips along with the employees' regular wages * * *. A provision is included under which the Secretary of the Treasury or his delegate is authorized to issue regulations under which the employer would be permitted to gear these new reporting procedures into his usual payroll. *It is the understanding of your Committee that regulations* *will be issued along these lines to the end that the procedures required of the employer with respect to this reporting requirement will be minimal.*" [H.R. Rep. No. 1548, 88th Cong. 2d Sess. 11 (1964) (Emphasis added.)]

That Congress was fully aware of charge tips as a part of tip income is reflected in the following:

"The employee would be required to report to his employer in writing the amount of tips received and the employer would report the employee's tips along with the employee's regular wages. *The employee's report to his employer would include tips paid to him through the employer as well as those received directly from customers of the employer.*" [H.R. Rep. No. 312, 89th Cong., 1st Sess. (1965) (Emphasis added.)]

As mentioned above, Congress established that, "only tips received by an employee on his own behalf and not on behalf of another employee constitute wages." IRS reliance on section 6041 as authority to require the employer to report on the Form W-2 all charge tips paid over to an employee ignores the fact that, in most cases, a portion of that amount will not constitute wages to that employee within the meaning of section 6041. It further ignores the fact that the general requirements of section 6041 preceded section 6053 and the 1965 amendment to section 6051, which limits the employer's reporting obligation to that tip income reported by the employee under section 6053. The more recent and specific requirements of sections 6051 and 6053 clearly supersede the earlier general requirements of section 6041 and they control the matter of reporting tip income.

In 1976, the Senate adopted an amendment which reaffirmed that employers need only report to IRS the tips, including charge account tips, reported to employers by their employees. The amendment nullified Revenue Rulings 75-400 and 76-231. However, since the House had not considered the matter, the Conference adopted a provision that IRS is not to take action to enforce its recent rulings on these matters before January 1, 1979.

The arguments that Revenue Rulings 75-400 and 76-231 are not consistent with the law and the plain intent of Congress are valid. The proposed legislation nullifying these Rulings is appropriate and should be adopted by the Congress.

STATEMENT OF ROBERT E. JULIANO, LEGISLATIVE REPRESENTATIVE, HOTEL AND RESTAURANT EMPLOYEES AND BARTENDERS INTERNATIONAL UNION

In behalf of Edward T. Hanley, General President of the Hotel and Restaurant Employees and Bartenders International Union, I appreciate this opportunity to appear before you today to urge the enactment of legislation to repeal two IRS revenue rulings which have an inequitable negative impact on gratuity employees.

In 1965, Congress thoroughly examined the reporting requirements and method of taxing income from tips received by employees. In recognition of long standing practices concerning tips, and in recognition of the fact that tips are an extremely unique type of income, Congress enacted very practical legislation, specifically requiring that an employee receiving tips must report them in writing to his employer monthly. The employer was then required to withhold income and social security taxes from those reported tips (Sec. 6053, Internal Revenue Code). Employers were also required to retain records of charge account tips and copies of the tip reporting statements filed by employees. Congress also recognized the common, indeed prevalent, practice of tip splitting and tip pooling, and determined that, in all fairness, only net tips received by an employee in his own behalf would constitute wages or income to that employee. Any portion of a tip which an employee splits or gives to a tip pool is income to the ultimate recipient. As a result of this determination, Section 6051 of the Code was amended in 1965 to provide that an employer's report to tip income on Form W-2 "shall include only" that tip income from the legislative history that Congress was fully aware of the practices and customs of tipped employees; and was deeply concerned that employer's reporting and recordkeeping requirements be minimal. This system has been in effect for over ten years, and there has been no showing of abuse or problems under it.

In December of 1975, the Internal Revenue Service issued Revenue Ruling 75-400 which unilaterally, and without prior notice or consultation, altered the entire approach of recordkeeping and reporting. This ruling required employers to keep independent records of the amount of charged tips for each employee and to reflect the total amount on the Form W-2, whether or not this same amount had been reported by the employee. This ruling changed the rules in the middle of the game, and made the employer the watchdog and compliance agent of the IRS. This ruling was clearly inconsistent with the law and Congressional intent. It overlooked the well-known fact that employees receiving tips often share the tips with other employees, and that to tax the employee on the full amount of charged tips allocated to him would be manifestly unfair. It imposed a new and extensive recordkeeping and reporting burden on employers; unjustifiably impugning the honesty of many thousands of tipped employees; and created a source of conflict between employer and employee.

In June of 1976, while Congress was considering amendments to the Internal Revenue Code which would revoke Revenue Ruling 75-400 and clarify the legislative intent of the prior laws, the IRS issued another ruling, Revenue Ruling 76-231. The issuance of this ruling was an attempt of the IRS to clarify their own intent, yet only complicated further the requirements for compliance. It did not meet the objections voiced with respect to the early ruling and actually increased the burdens on both the employer and employee. Specifically, it created new additional complicated reporting requirements for waiters; continued to require employers to report all tips on a gross basis, including "unreported charged tips"; and created new complicated reporting requirements for employers. The result would have been that employees would report on a net basis, the employer would report on a gross basis, and a reconciliation would have been required somewhere along the line. An administrative nightmare would have been created. Furthermore, it would have subjected employees to taxes on wages they never received, i.e., pooled tips, unless they affirmatively filed a statement with the IRS explaining the circumstances.

I must emphasize at this point that the practice of tip splitting and tip pooling is so general in gratuity occupations that it has been recognized by Congress since 1965 and taken into account in other legislation as well, specifically the Fair Labor Standards Act. In that legislation Congress also declared an intent not to interfere with that time honored practice.

In 1976 the Senate passed a clarifying amendment, specifying that the only tips which an employer must report were those reported to him by the employee under the present laws. It would have revoked Rev. Rul. 76-231. Since the controversy arose after the House had considered the tax reform bill, there was no comparable measure in the House version when it went to conference.

The Conference Committee was very concerned about the problems posed by the new revenue rulings, but was unable to discern final resoltuion without additional study. Accordingly, the Conference Committee decided to legislate a two-year moratorium on the new rulings, stating that the IRS would not make any changes in the existing tip reporting requirements (through implementation of Rev. Rul. 76-231 or otherwise) before January 1, 1979.

This two-year period was set in order that the Congress have an opportunity to look closely at the problem and to work out what legislative changes, if any, are necessary in the tip income reporting requirements.

IRS argues that there is substantial non-compliance. Yet it offers no support for this allegation. Furthermore, in the past two years, it has not provided any rationale or data to support its proposals.

One final point is in order. Whenever the IRS talks about changing the rules for tipped employees, it uses as an example a waiter at a fine, high priced restaurant who when combining his salary and tips is earning a reasonably decent living.

It is high time that the IRS recognized that the small handful of gratuity employees so situated, unfortunately, is a miniscule percentage of the food service employees in the United States. Indeed, according to government statistics, employment in the food service industry is the lowest paying sector of the non-agricultural economy.

I therefore respectfully urge that the Congress confirm its 1965 judgment and permanently repeal the IRS rulings. For, simple equity supports the retention of the spirit of the actions of Congress over ten years ago.

STATEMENT OF STEPHEN SKARDON, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

Mr. SKARDON. Mr. Chairman, my name is Steve Skardon. I represent the National Association of Retired Federal Employees. On behalf of our 300,000 members, I would like to thank you for inviting us to appear here today in support of S. 2128, introduced by Senator Inouye and cosponsored by, among others, Senator Dole, Senator Hathaway, and Senator Haskell; and S. 2628, introduced by Senator Bumpers.

Before I begin, I would like to ask that the prepared statement of our president, John McClelland, be included in the record at the conclusion of my remarks. There is one technical correction to his statement.

I was informed today that the Treasury Department has revised its cost estimates on S. 2128. The revenue loss that they now anticipate from the enactment of the bill is $727 million as opposed to $963 million that they had come up with before.

Senator PACKWOOD. That correction will be noted.

Mr. SKARDON. Mr. Chairman, as you can tell from our name, one of our primary interests is legislation which provides roughly comparable tax treatment between those with substantial social security income and those with little or no social security income.

The major problem, as Senator Hathaway pointed out earlier, is that social security income is tax free at all income levels. This naturally is a very lucrative tax break for those who are receiving social security income.

Since 1954, Congress has attempted to extend comparable tax relief to those with little or no social security by means of a tax credit. Currently the credit—which is known as the tax credit for the elderly—is embodied in IRS schedule R. It was enacted in 1976 as part of the Tax Reform Act. The specific details of this tax form were outlined by Senator Hathaway earlier and are also outlined in Mr. McClelland's formal statement, so I will not go into all of that again.

It is our position that the current tax credit for the elderly is inadequate, that it is arbitrarily limited to low-income elderly, and that it provides an unrealistically low level of tax relief. It is for those reasons that we support S. 2128.

Simply stated, enactment of this bill would substantially broaden and restructure the current tax credit for the elderly. The bill would bring about a more realistic level of tax relief while making that relief available to all eligible persons 65 and over, not just those in the lower income levels.

Mr. Chairman, we believe in this bill because we believe that all persons similarly situated should be treated equally by the tax laws. That is not currently the case with the elderly.

Under the present law, taxes owed by two persons 65 and older with identical incomes could vary by as much as $1,700 or more, the difference being that one taxpayer receives substantial social security income.

The reason social security income is tax free is that Congress has always considered the ability of elderly persons to meet basic medical and financial needs of such social significance as to warrant this special tax consideration. We agree with that policy.

However, we also feel the ability of elderly persons not covered by social security is no less important and deserves the same consideration. For that reason, we support S. 2128.

The bill now has nearly a third of the Members of the House as cosponsors, including 11 members of the House Ways and Means Committee.

On the Senate side, there are now 14 cosponsors.

We believe that this kind of support certainly justifies serious consideration being given to this bill. We believe that it is a good bill, it is one that has evolved over a long period of time, after very careful study and research. I think it is fiscally sound, it is politically viable, and it is a realistic way to bring about an effective end to a very serious and significant tax inequity.

Jim?

STATEMENT OF JAMES M. HACKING, NATIONAL RETIRED TEACHERS ASSOCIATION AND AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. HACKING. Mr. Chairman, I would like to identify myself. I am James Hacking, the assistant legislative counsel for the 12-million member National Retired Teachers Association/American Association of Retired Persons. With your permission, I ask that my statement be included in the record and that my statement be amended to reflect the revised estimates on revenue loss that Mr. Skardon mentioned.

Senator PACKWOOD. It will be so amended.

Mr. HACKING. Finally, I would like to associate myself with Mr. Skardon's remarks and add that, over the years, this is the one item in the Federal income tax code in which the greatest number of elderly persons who are taxpayers are interested. I know the Treasury is opposed to this bill; however, the objective of the bill is to achieve horizontal tax equity, and I think that that consideration is, for us and for the National Association of Retired Federal Employees, the overriding concern.

I hope that this committee will act with respect to this bill and that some changes will be made in the current elderly tax credit. Thank you.

Senator PACKWOOD. Well done.

Does the Treasury want to comment?

Mr. SAMUELS. We do oppose the bill, Senator, for several reasons. The elderly already recive susbtantial tax benefits in the form of additional personal exemptions, exemption from gain on the sale of residence, and we are not sure that it is appropriate to use the tax system to grant the elderly further favorable tax treatment.

Senator PACKWOOD. Why not?

Mr. SAMUELS. Well, because I think that——

Senator PACKWOOD. I mean, apart from whether or not they should be granted any further tax treatment in our tax system.

Mr. SAMUELS. There are about 18 million of the elderly who are nonfilers, who have incomes below the minimum filing requirements, who do not pay income taxes at all. Any relief granted through the tax system does nothing for those people who probably are more in need of assistance than the taxpaying elderly.

So I think that is the principal question, is do we want to use the tax system when we are going to cut out those 18 million elderly.

Now, even among the 6 million elderly who do pay taxes, more than 70 percent of the benefits of this bill would go to persons earning more than $15,000 a year—something like more than 27 percent would go to elderly with incomes of more than $30,000 a year and about 15 percent would go to elderly with taxable incomes of over $50,000 a year.

I think it would be inequitable to take this kind of revenue—and it is an expensive bill—$727 million is our current revenue estimate—and spend it this way.

Finally, let me just add that we particularly oppose indexing the base. Indexing requires careful study. We think it would be a mistake to index the tax law piecemeal and it would particularly be a mistake to put one group of taxpayers in a better position with respect to inflation than an entire other group of taxpayers, a different, separate group of taxpayers.

Senator PACKWOOD. Senator Dole?

Senator DOLE. I do not have any questions. Is there some—I guess we suggest that since nearly 18 million senior citizens most of those 6 million who would are—what percent are above——

Mr. SAMUELS. 70 percent are above $15,000; 27 percent above $30,000.

Senator DOLE. That is gross income?

Mr. SAMUELS. I cannot answer that. It says income on the chart. I would have to——

Senator DOLE. As I understand it, only those with adjusted gross incomes of under $7,500 with no social security are eligible to receive the current $375 credit and persons with incomes between $7,500 and $12,000 have the credit phased out.

Mr. SAMUELS. This bill would eliminate that phaseout. One of the features that it has is the elimination of that adjusted gross income phaseout, so you would get the credit regardless of what your adjusted gross income is.

It does three things—basically three things. It increases the amount against which you can claim the credit. It eliminates the AGI phaseout and it indexes the amount for inflation.

Senator DOLE. Right.

We do increase the maximum base figure and we do index the base and we do eliminate the phaseout, but perhaps the price tag is lower today than it was yesterday. There may be some room for compromise even further, if necessary.

I know indexing is controversial. Mr. Sunley was here last week. We asked him a no-win question. We asked him if you would have to have something, would you rather have Roth-Kemp or Steiger-Hansen or indexing. On that basis, he took indexing.

Mr. SAMUELS. I think that is right. But did you ask him if he would take indexing in this bill only as another one of the options?

Senator DOLE. Well, we wanted to get indexing started. We thought we would just slip it in here and see how it goes.

Mr. SAMUELS. I think indexing on a piecemeal basis, I think the Treasury believes it deserves careful study and if it is going to be done, it should be done only after that study.

Senator DOLE. If you do not want to do it piecemeal, I have a bill in that indexes 16 different things.

Mr. SAMUELS. Well, that would require careful study.

Senator DOLE. That is what they told me last year, and in the other administration.

Senator PACKWOOD. The one statement that has to be made, Bob—and it is an accurate statement—is that Treasury does not change. It does not matter whose administration it was, their position remains the same.

Mr. SKARDON. Senator, if I may make two points to respond to Treasury's statement—and they will be real quick—first of all, in the year that this bill has been in existence, they have never responded to our only argument, which is that this bill grants comparable tax treatment to people who are not receiving substantial amounts of social security.

Second, and I guess I say this somewhat substantially, is that they talk about tax reform and they talk about tax equity. but when it comes down to it, they back away from it every time.

Any time you have a tax reform measure or a tax equity measure, somebody in the middle and upper income brackets is going to benefit if it is true equity. Those are the people who are paying the taxes. So I am confused by the administration's rhetoric on tax reform, when they come down and perform like this.

Senator PACKWOOD. I understand.

Mr. HACKING. Senator, I would also point out that most of those elderly persons who do not have any Federal income tax liability are persons who are on social security, which is tax exempt and the measure of the tax benefit that goes to social security recipients goes up, increases every single year, every time there is an automatic increase in benefits.

Now, what this bill is aimed at is providing a roughly comparable tax break to those older persons who have income from sources other than social security.

Thank you.

Senator PACKWOOD. Gentlemen, thank you.

[The prepared statements of the preceding panel follow. Oral testimony continues on p. 156.]

STATEMENT OF JAMES M. HACKING FOR THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

I am James Hacking, Assistant Legislative Counsel for the 12 million member National Retired Teachers Association and American Association of Retired Persons. I am here this morning to indicate our Associations' strong support for S. 2128, legislation introduced by Senator Daniel Inouye to improve the tax credit for the elderly.

Because a sizable portion of our 12 million members are retired civil service employees, teachers and other public employees who do not receive social securtiy benefits our organizations have a direct interest in proposals to revise and improve the federal tax treatment of their pension and retirement income.

BACKGROUND

As you are aware, the Federal Government provides substantial tax benefits to millions of social security recipients. Their benefits are not counted in gross income for federal income tax purposes and are thus tax exempt. This tax benefit has been provided in recognition of the decrease in total income most persons experience upon retiring and the increased drain on their budgets resulting from age-related factors such as increased medical expenses.

In contrast to social security benefits, income from public pensions is taxable. For the purpose of equalizing federal income tax treatment of social security recipients and those receiving other forms of retirement income, Congress enacted the Retirement Income Credit (RIC) in 1954. From 1954 to 1976, however, Congress legislated substantial increases in social security benefits without providing equivalent increases in the tax benefits available under the RIC.

With passage of the 1976 Tax Reform Act, Congress attempted to address this problem by updating and restructuring the credit. A new Tax Credit for the Elderly (TCE) was created making limited improvements in the old RIC. The new credit increased the tax relief available to most non-social security retirees by substantially increasing the maximum base amounts used to compute the credit. Some of the complex provisions of the old law were revised to simplify computation of the credit and the discriminatory treatment of earned income in the case of taxpayers age 65 and over. Despite these improvements, many of the flaws of the old RIC are perpetuated by the new TCE and unfortunately new inequities are created.

PROBLEMS AND INEQUITIES OF CURRENT TCE

To address present inequities existing in the TCE in a comprehensive manner, our Associations support passage of S. 2128, introduced by Senator Daniel Inouye and cosponsored by 12 Senators. (An identical measure, H.R. 8818, introduced by Representative Skip Bafalis, is pending in the House with 136 cosponsors.) S. 2128/H.R. 8818 would first, raise the credit's maximum base amounts from $2,500 to $3,000 for single taxpayers and from $3,750 to $4,500 for married couples; second, cost-index these base amounts to keep pace with increases in the cost of living; and third, eliminate the adjusted gross income (AGI) restrictions on the credit which were imposed in 1976. The cost of and rationale for each of these liberations are discussed in detail below.

Maximum base amounts

Although only 2 years ago Congress provided large increases in the maximum base amounts used to compute the credit, our Associations believe the $2,500 base amount used by single taxpayers and $3,500 base amount used by married couples are still too low. For purposes of horizontal tax equity these amounts should be increased as proposed in S. 2128 to correspond to the average annual benefits available to social security recipients. In 1977, the average annual social security benefit award was approximately $3,000 for an individual and $4,500 for a married couple.

If the maximum base amounts are increased to $3,000 and $4,500 for taxpayers over age 65, with no changes in any other aspect of the TCE law, the fiscal 1979 revenue loss calculated at 1976 income levels would be $106 million. According to Department of Treasury estimates,[1] the revenue loss distribution among income classes would be as follows:

Adjusted gross income class:	*Revenue loss (in millions)*
$0 to $5,000	$3
$5,000 to $10,000	50
$10,000 to $15,000	45
$15,000 to $20,000	8
$20,000 and over	-----
Total	106

Cost indexing base amounts

Because social security benefits are automatically indexed in accordance with increases in the Consumer Price Index, the TCE maximum base amounts should similarly be indexed as proposed by S. 2128 so that the tax relief provided non-social security retirees will automatically keep pace with the value of the tax break that increases automatically as social security benefits increase. If the $3,000 and $4,500 base amounts are accepted and cost-indexed according to increases in the CPI, but no other changes in the TCE law are made, the Department of Treasury anticipates a 6 percent annual increase in revenue loss estimates based on a predicted 6 percent annual inflation rate. If the AGI phase-outs are removed, as proposed by S. 2128, a 10 percent annual increase in revenue loss could be expected.[2]

AGI phaseout levels

During consideration of the 1976 Tax Reform Act, Congress decided to target the tax relief available under the TCE to lower-income individuals. Consequently a provision was added to the new credit requiring that, for persons age 65 or over, the base amounts be reduced by $1 for every $2 of adjusted gross income in excess of $7,500 for singles ($10,000 for married couples). This provision has the effect of limiting use of the credit to individual taxpayers who have total incomes below $12,500 and to married couples with incomes below $17,500.

Our Associations feel these phase-out levels are too low and deny many middle income taxpayers needed tax relief. These restrictions also contradict the credit's objective of equal tax treatment for social security and non-social security retirees because social security recipients receive tax-free benefits regardless of the level of their total income.

Furthermore, the AGI phase-out levels apply only to taxpayers age 65 and over. Public retirees under age 65 use a different set of TCE rules which, in most cases, are more liberal than the age 65 and over rules. Consequently, many taxpayers

[1] Department of Treasury memorandum to Mr. Sunley from Mr. Wilkins, dated Feb. 27, 1978.
[2] *Ibid.*

who retire before age 65 and qualify for the TCE will ironically find that their tax credit will either decrease or phase-out completely upon reaching age 65.

Because the AGI phase-out feature makes the tax relief available under the TCE inadequate for many middle-income taxpayers and creates a disparity in the treatment of taxpayers under age 65 compared to those aged 65 and over, we believe the AGI phase-out should be eliminated from the law as provided for in S. 2128.

The net cost of eliminating the AGI phase-outs has been estimated by the Joint Committee on Taxation to be $578 million at 1976 levels of income.[3] The revenue loss distribution among income classes would be as follows:

Adjusted gross income class	Revenue loss (millions)	Percent distribution
0 to $10,000	$21	4
$10,000 to $15,000	137	24
$15,000 to $20,000	136	24
$20,000 to $30,000	129	22
$30,000 to $50,000	84	8
$50,000 to $100,000	49	4
$100,000 and over	22	
Total	578	

TOTAL COSTS OF S. 2128

If all three liberalization features contained in S. 2128 are accepted by Congress, the revenue loss estimated by the Treasury Department would be as follows:[4]

Fiscal year:	Revenue loss (in millions)
1979	$1,105
1980	1,170
1981	1,295
1982	1,330
1983	1,465

The distribution of that revenue loss at 1976 income levels is estimated to be:[5]

Adjusted gross income class	Revenue loss (millions)	Percent distribution
0 to $5,000	$3	
$5,000 to $10,000	71	9
$10,000 to $15,000	192	24
$15,000 to $20,000	165	20
$20,000 to $30,000	163	20
$30,000 to $50,000	109	14
$50,000 to $100,000	64	8
$100,000 and over	29	4
Total	796	

The Administration, as well as some members of Congress, oppose S. 2128 because first, the cost of the bill would be over $1 billion in the first year and would increase about 10 percent a year; and second, the bill would distribute this revenue loss in a manner at variance with strict ability-to-pay principles since one quarter of the benefits would go to taxpayers with incomes over $30,000. This distribution results largely from the total elimination of the AGI phase-out levels. In addition, there is opposition to using an automatic indexing device for any specific item of the tax code. Some opponents maintain it is unfair to put only one group of taxpayers in an inflation-proof tax position while other opponents fear any indexing would establish a dangerous precedent for other tax provisions.

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[3] Letter to Representative Skip Bafalis from Herber Chabat, Deputy Chief of Staff for the Joint Committee on Taxation, dated Aug. 18, 1971.

[4] Department of Treasury memorandum to Mr. Sunley from Mr. Wilkins, dated Feb. 17, 1978.

[5] Ibid.

In response to those who would tend to look unfavorably on S. 2128 because of its revenue loss distribution consequences, our Associations would urge them to keep in mind that the intent of the original RIC and now of the TCE is to provide older persons who do not receive social security with an income tax treatment roughly equivalent to that available to social security recipients. Our Associations feel that, in this case, the principle of horizontal equity should take precedence over the ability-to-pay principle.

In response to those who would look unfavorably on S. 2128 because it would index the new base amounts it would establish, our Associations would point out that the indexing would preserve over time the horizontal equity that the bill would restore. We would add that in the past the Congress has failed to make ad hoc adjustments in the base amounts of the old RIC and the new TCE with sufficient frequency to preserve horizontal equity. Since social security benefits and the value of the commitment tax break now go up automatically, we think an exception to the "no-indexing" in the tax code rule should be made in this case. The rationale for the exception is the preservation of horizontal tax equity between older persons who receive social security and older persons who receive other forms of income.

Finally, in response to those who would tend to look unfavorably on S. 2128 because of its revenue loss consequences, our Associations would suggest that the revenue loss could be diminished by liberalizing substantially but still retaining the AGI phase-out devise that exists under present law. While we believe the present $7,500 (for single persons) and $10,000 (for married couples filing jointly) trigger figures for the AGI phase-out are much too low and while we would like to see these phase-outs eliminated entirely, we realize that substantial liberalization of the trigger figures would cut the revenue loss under S. 2128 substantially and yet still help the overwhelming majority of those who most need the tax relief the bill would provide. For example, a trigger figure of $15,000 for individuals and $17,500 for married couples would reduce the revenue loss of the bill by nearly one half.

ADDITIONAL TAX ITEMS

Another reform item related to the TCE could be included as an amendment to S. 2128. While S. 2128 would raise the base amounts used by retirees age 65 and over, it would not raise the base amounts used by public retirees under age 65 who qualify for the credit. If the base amounts were raised for persons age 65 and over and not for persons under age 65, then this different set or TCE rules based on age would further aggravate the disparity which already exists in the tax treatment of these two groups of retirees. A single taxpayer under age 65 would be entitled to a credit that could be as much as $75 less than the credit received by a single taxpayer age 65 or over with the same amount of total income. Our Associations urge you to correct this potential disparity that would result from passage of S. 2128 in its current form by providing equal increases in the base amounts (to $3,000 and $4,500) used by public retirees under age 65.

Our Associations also support legislation (S. 2628) that has been proposed by Senator Dale Bumpers to eliminate the requirement that married couples must file joint returns in order to use the $5,200 sick pay exclusion. This bill would correct an inequity in this law that was created as a result of passage of the 1976 Tax Reform Act. Under current sick pay law, the exclusion is phased-out on a dollar-for-dollar basis by adjusted gross income in excess of $15,000. This $15,000 limit, however, is applied to both single and married couples alike. This places an undue financial hardship on married couples where the non-disabled spouse works to generate additional income to cover medical expenses which are often high in the case of a disabled individual.

STATEMENT OF JOHN F. McCLELLAND, PRESIDENT
THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES

Mr. Chairman, I am John F. McClelland, President of the National Association of Retired Federal Employees (NARFE). The Association is 57 years old and composed entirely of retired Federal employees, their spouses and survivors. We have a dues-paying membership of nearly 300,000, representing the interests of 1.5 million retired Federal workers, their spouses and survivors. We very much appreciate the efforts of this committee to examine the problems of the Tax Credit for the Elderly and the tax treatment of disability income.

Let me say initially that our organization does not argue that federal tax policy is unreasonable in its treatment of the elderly. Indeed, the tax code contains numerous relief mechanisms for older Americans which have helped them to lead more useful and productive lives.

However, it is our chief purpose in these hearings to call your attention to a major source of tax inequity in the treatment of different groups of older Americans. Specifically, I am talking about the Tax Credit for the Elderly (TCE).

TAX CREDIT FOR THE ELDERLY (S. 2128)

Mr. Chairman, the primary legislative concern of our organization is the tax treatment of older Americans with little or no social security income. For many years the tax treatment of these persons as compared to that of their social security counterparts, was roughly comparable. However, as a result of rules governing the TCE, we feel that is no longer true.

Under current law all social security income is tax exempt. The rationale behind this lucrative tax advantage is that Congress considers the ability of elderly persons to meet basic medical and financial needs of such social significance as to warrant this special tax consideration. This exemption is not something earned by the recipient nor a benefit for which one must otherwise qualify. It is automatic and given to everyone receiving social security income. We have no problem with this.

However, we do feel that the ability of elderly persons not covered by social security to meet the same basic needs is no less important. We believe that in the interest of equity there should be some balancing tax mechanism available to these persons to provide roughly equivalent relief.

Since 1954 Congress generally has agreed with this concept, and gradually evolved the current Tax Credit for the Elderly (TCE), which was passed as part of the Tax Reform Act of 1976. It is the purpose of the TCE to provide roughly comparable tax treatment to persons not covered by social security.

However, it is our contention that the current "means test" which limits the availability of the credit to low income elderly renders the TCE ineffective and prevents it from even coming close to dealing with this problem. Further, we feel that inflation over the last few years has substantially reduced the adequacy of the credit amount.

CURRENT LAW

Perhaps it would be well to briefly summarize the current law:

Under the TCE, an individual is allowed to subtract 15 percent of a maximum base figure (otherwise known as the "Section 37 amount") from taxes owed for a given tax year. However, the maximum base figure is reduced by amounts and sources of income.

An individual's maximum base figure is determined in the following manner:

Individuals 65 and over* (IRS Schedule R) are allowed to take into account for purposes of computing the maximum base figure up to $2500 of adjusted gross income ($3750 for couples filing jointly) to be reduced by

(1) the amount of social security and/or railroad retirement income the individual has received during the tax year, and

(2) $1 for every $2 in adjusted gross income over $7500 ($10,000 for couples filing jointly).

In other words, for persons 65 and older, only those with adjusted gross incomes under $7500 and no social security income are eligible for the full $375 credit (15 percent of $2500). Those persons with modest incomes ($7500-$12,500) receive little or no credit, while those with incomes above $12,500 receive nothing. Of course, the maximum base figure is reduced by any social security income (or railroad retirement income) up to $2500, at which point the individual's credit is completely eliminated ($3750 for couples filing jointly).

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* Public retirees under 65 (IRS Schedule RP) are allowed to take into account for purposes of determining the maximum base figure up to $2500 of retirement income ($3750 for couples filing joint returns) to be reduced by

(1) the amount of social security and/or railroad retirement income the individual received during the tax year, and

(2) $1 for every $2 of earnings over $1200 and below $1700, and dollar-for-dollar over $1700.

(3) for persons under 62, dollar-for-dollar for earnings over $900.

BAFALIS-INOUYE BILL (HR 8818 and S. 2128)

In the first session of this Congress, Senator Inouye and Congressman Bafalis introduced HR 8818 and S. 2128, which are identical bills designed to upgrade the TCE and narrow the gap between those receiving social security and those with little or no social security income. This bill has the full support of our organization along with that of many other groups.

The Bafalis-Inouye bill is premised on three main points:

(1) The maximum base figure (Section 37 amount) used in computing the TCE be raised to $3000 for individuals and $4500 for couples filing jointly,

(2) The maximum base figure be cost-indexed to reflect changes in the cost of living each year, and

(3) The phase-out figures on the adjusted gross income of persons 65 and older be eliminated (Schedule R only).

On the House side there are 138 cosponsors of this legislation, including 11 members of the Ways and Means Committee, and
11 members of the Ways and Means Committee, and Chairman Pepper of the House Aging Committee. There are 13 Senate cosponsors, including Senators Domenici and Chiles of the Senate Aging Committee, and Senators Hathaway and Dole of the Senate Finance Committee.

Our organization believes that if enacted, S. 2128 will rectify the significant deficiencies of the current law. Our support is based solely on arguments of equity and simple fairness.

First, by increasing the amount of the maximum credit from $375 to $450 Congress would be raising the credit amount to a more realistic and substantial level. Historically, the maximum base figure on which the credit is computed has been fixed arbitrarily at a level roughly equivalent to the average annual primary social security benefit. S. 2128 raises that maximum base figure to a level consistent with the current social security figure.

Secondly, the bill would insure that the maximum amount of the credit will be increased each year to keep pace with the cost-of-living. This has been a major problem in previous years in that Congress' agenda has often squeezed out consideration of relatively insignificant updating legislation.

Thirdly, the bill insures that all persons 65 and older will be eligible for either the tax exemption under social security or a tax credit under the TCE. Due to the current $7500/$10,000 phase-out figures on adjusted gross income, the TCE excludes all but low-income elderly. Since social security income is tax-free at all income levels, our membership feels that TCE should also be available to all other qualified taxpayers regardless of income. (The attached chart demonstrates the profound inequity created by this double tax structure.)

Fourthly, S. 2128 will assure that qualified individuals will not be entitled to a reduced credit when they reach age 65 as they are under the current law.

According to official estimates from the Treasury Department and the Joint Committee on Taxation, the additional revenue loss affected by enactment of the Bafalis-Inouye proposal is approximately $963 million.

Mr. Chairman, this is a good bill. It is one which has evolved over a long period of time after much research and effort. Senator Inouye, along with Senator Dole and Senator Hathaway have labored many hours to develop a proposal that would be fiscally sound, and yet politically viable. The fact that the legislation has such widespread support, both in Congress and among the elderly, attests to the validity of their work. On behalf of the nation's elderly, I urge this committee to approve S. 2128 as part of this year's tax legislation.

TAX TREATMENT OF DISABILITY INCOME (S. 2628)

Mr. Chairman, Congress has a long-standing policy of granting special tax treatment to a portion of an individual's income received as a result of sickness or disability. Qualifying individuals are allowed to exclude up to $100 a week in income received as a result of sickness or disability. The maximum exclusion is $5200.

While the $100-a-week exclusion was continued, the Tax Reform Act of 1976 severely restricted eligibility for the exclusion. Specifically, the new law requires that persons seeking to qualify for the exclusion must (1) be "permanently and totally" disabled, (2) submit a doctor's certificate to that effect, and (3) file a joint return if married. In addition, Congress imposed a dollar-for-dollar phase-out of the exclusion at $15,000, while lowering the maximum allowable age for eligibility from 70 to 65.

Obviously, as a result of these new restrictions, many persons who had been using the exclusion suddenly found themselves with enormous increases in their tax bills. While NARFE does not defend use of the exclusion by persons not truly disabled, we do feel that some aspects of the new rules are overly restrictive and arbitrary-- the most significant of which is the requirement that persons using the exclusion file a joint return, if married. Senator Bumpers' bill, S. 2628, would eliminate this requirement from the law.

Mr. Chairman, there is little justification for maintaining this provision.

Since the exclusion phases-out when the couple's adjusted gross income reaches $15,000, this has caused a significant hardship on the financial plight of the disabled American. (This same $15,000 phase-out is also used for a single taxpayer.) Disability income seldom is enough to meet necessary medical and social needs and, thus, often forces the employable spouse to go to work to pay for additional expenses. In many cases, it is the additional income generated by the second spouse that pushes the couple's adjusted gross income above the $15,000 phase-out figure. Mr. Chairman, this is a needless difficulty for these people. The revenue loss incurred by passage of this legislation would be minimal, while it's benefits would be of great assistance to these persons in financial need.

Schedules R & RP—Credit for the Elderly

(Form 1040)
Department of the Treasury
Internal Revenue Service

(Public Retirees Under 65 See Schedule RP on Back)

▶ Attach to Form 1040. ▶ See Instructions for Schedules R and RP (Form 1040).

1976

Name(s) as shown on Form 1040 | Your social security number

Schedule R—Credit for the Elderly—Individual(s) 65 or Over Having Any Type of Income

R

Important: *You may elect to use Schedule RP if you are married filing a joint return and one spouse is 65 or over and the other spouse is under 65 and has public retirement system income. However, unless both spouses elect to use Schedule RP, you must use Schedule R.*

Filing Status and Age (check only one)

- A ☐ Single, 65 or over
- B ☐ Married filing joint return, only one spouse 65 or over
- C ☐ Married filing joint return, both spouses 65 or over
- D ☐ Married filing separate return, 65 or over, and have not lived with your spouse at any time during the taxable year

1 Initial amount of income for credit computation. Enter $2,500 if block A or B checked, $3,750 if block C checked, or $1,875 if block D checked		1		
2 Deduct:				
a Amounts received as pensions or annuities under the Social Security Act, the Railroad Retirement Acts (but not supplemental annuities), and certain other exclusions from gross income (see instructions)				
b Enter one-half the excess of your adjusted gross income (Form 1040, line 15c) over: $7,500 if block A checked, $10,000 if block B or C checked, or $5,000 if block D checked				
3 Total of lines 2a and 2b		3		
4 Balance (subtract line 3 from line 1). If zero or less do not file this schedule		4		
5 Tentative credit. Enter 15% of line 4		5		
6 Amount of tax shown on Form 1040, line 18		6		
7 Credit for the Elderly. Enter here and on Form 1040, line 48, the amount on line 5 or 6 whichever is smaller ▶		7		

	Current Law			Proposed Law (HR 8818 and S 2128)	
Income	Taxes Paid by Single Person* With No Social Security Income		Taxes Paid by Single Person* Whose Income Includes $5000 Social Security	Taxes Paid by Single Person* With No Social Security Income	
7,500	1089	(375)**	$ 403	1014	(450)**
10,000	1896	(188)	895	1634	(450)
12,500	2768	-0-	1464	2318	(450)
15,000	3512	-0-	2084	3062	(450)
17,500	4332	-0-	2768	3899	(450)
20,000	5221	-0-	3512	4771	(450)

*Person 65 or older/does not include other exemptions or credits

**Amount of credit used in computing taxes owed

Senator PACKWOOD. Next we will take Dean McCormick and his panel: Mr. Parren, Mr. Troll, Mr. Hand, Mr. Phillips.

Mr. Schoeneman, I am sorry. You should be up with this panel also. I apologize.

Gentlemen, as you are aware, the panel has 15 minutes. I will tell the other witnesses, I will try to stay to about 1 o'clock in the hopes of being able to finish the rest of the witnesses today rather than holding you to 8:30 in the morning, but I will hold the panel to the time allotted so that the other witnesses can get on today.

Go right ahead.

STATEMENT OF DEANE E. McCORMICK, CHAIRMAN, COORDINATING COMMITTEE, DECQ COMMITTEE

Mr. McCORMICK. Mr. Chairman and members of the Senate, my name is Deane McCormick and I appear on behalf of the DECQ committee in support of S. 3288.

S. 3288 would grant a deduction from gross income to employees for their contributions to plans qualified under section 401 of the Internal Revenue Code. The amount deductible is 10 percent of compensation, but no more than $1,000. The deduction is from gross income, rather than an itemized deduction, and thus benefits everyone, even though they take the standard deduction.

Any private employer qualified plan counts, whether it be of a pension, profit-sharing or thrift-saving type, and any contribution counts, whether it is mandatory or voluntary.

Additionally, provision is made to permit the qualified plan participant the flexibility of contributing to an IRA in case that is his preference.

I am the chairman of the coordinating committee of the DECQ committee. DECQ is an acronym for deductible employee contributions to qualified plans. Seeking such legislation is the sole purpose of the committee.

A list of the committee sponsors is attached to my written statement, which I ask be made a part of the record of these hearings.

The committee is composed of various employers, both large and small, with locations and employees in all 50 States. The businesses are of many different types: manufacturing, retail, and personal service.

As a group, the members of DECQ have 745,000 employees.

Mr. Chairman, we believe this bill, S. 3288, will help solve many of the pension funding problems facing this Nation. While the private sector plans have accumulated $279.6 billion to fund pensions, statistics indicate that only 47 percent of the private sector work force is currently covered under existing arrangements. Obviously, much remains to be done.

Other witnesses of this panel will detail how S. 3288 will help correct the existing law's negative impact on contributory and noncontributory plans. Also, they will discuss the problem of many employers who, faced with the burdens of ERISA, need incentives and assistance in establishing and maintaining and improving qualified plans.

Social security alone is inadequate. Employees whose earnings exceed $10,000 can expect a primary social security pension of less than 35 percent of their final pay. Any significant improvement of social security would entail either increased social security taxes, or increased unfunded liability, wherein we mortgage the expectation of future generations of employers and workers.

These alternatives are not acceptable, neither is the reduction of social security benefits.

While S. 3288 will not solve all of these problems, it clearly would be a reasonable, responsible step in the right direction. This legislation would encourage a socially desirable goal—the establishment of new, qualified pension plans and the provision of additional benefits under existing plans by providing a reasonable means to obtain it—deductible employee contributions to qualified plans to help fund future pension benefit commitments.

The need for this kind of legislation is widely recognized, as evidenced by the number of other proposals to permit limited deductibility of employee contributions to qualified plans which are now under consideration. In our opinion, S. 3288 is superior to these alternative proposals in that it would avoid unnecessary complexity and additional administrative costs which emanate from the more complex provisions of other bills.

Ie would use the existing structure——

Senator PACKWOOD. Let me say again that I am going to hold this panel to 15 minutes, and you have used about 6 now.

Go ahead.

Mr. McCORMICK. It would use the existing structure of qualified plans to achieve the desired objectives of improving pension benefit coverage for employees. It would afford all employees an opportunity to set aside additional funds on a tax encouraged basis to help provide additional pension benefits for themselves and their families.

In summary, the need for DECQ legislation is clear. S. 3288 is the best of the legislative proposals which have been formulated to permit limited deductibility of employee contributions to qualified plans. We respectfully urge you to support its enactment.

Senator PACKWOOD. Which of you is going to be next?

Yes, sir.

STATEMENT OF JOSEPH S. PARREN, DIRECTOR, NATIONAL AUTOMOBILE DEALERS AND ASSOCIATES RETIREMENT TRUST

Mr. PARREN. Mr. Chairman, I am Joseph Parren and I am the director of the NADA Retirement Trust, more commonly known as NADART. NADART manages a fund of over $300 million representing the retirement assets of over 5,300 and more than 75,000 employees nationwide.

On behalf of the National Automobile Dealers Association, I appreciate the opportunity to present to this subcommittee our comments on S. 3288 which we feel will solve one of the major problems facing small employers such as automobile dealers. We support this bill which we feel will not only provide equitable treatment for employees of company-sponsored plans, but will solve a serious plan participation problem which we are facing today.

During the 21 years that NADART has sponsored master plans, there has been a tremendous increase in dealers who have adopted one of our master plans. However, today we are experiencing a reversal of this trend.

Last year alone, we lost 130 plans of which 39 plans were due to employee disinterest—meaning, participants wanted IRA's. Since January of this year we are experiencing such terminations at an annual rate of 75.

In general, a dealer who adopts one of NADAR's master plans, employs fewer than 20 employees. The financial position of the typical dealer does not permit him to maintain a plan without seeking to share the cost with his employee by requiring contributions of them. Accordingly, a substantial percentage of the plans adopted by dealers require employee contributions to participate in the plan.

This bill, we believe, will eliminate the prejudice which presently exists against employees participating in company-sponsored plans. The Employee Retirement Income Security Act of 1974 permits certain individuals to use pretax dollars to fund a retirement benefit by deducting contributions to an individual retirement account—IRA. Many participants in our contributory plans are electing to withdraw to participate in an IRA. There is no doubt that the deductibility of the individual's contribution attracts him away from employers' plan.

A dealer must be able to demonstrate that a fair cross-section of his employees participate in the plan at all times in order to retain the tax-qualified status of the company plan. When many of the participants elect out of the plan and are lower-paid rank and file employees, the employer is unable to demonstrate that a fair cross section of his employees participate in the plan.

As a result, the tax-qualified status of the plan is lost and employees suffer.

Withdrawal of even a few employees has a significant impact on the employer's ability to maintain tax-qualified status. For these reasons, NADART stands in favor of providing a deduction to the employee for his contributions to the company-sponsored plan. We believe that S. 3288 offers the best solution to the problems we face today. It does not require a complicated computation to determine the amount of deductions. This will simplify procedures in administering the deductions for employee contributions.

Another significant aspect of the approach of S. 3288 compared to other bills addressing the problem, is that it relies on the well-established rule governing tax-qualified retirement plans. Other bills would require the application of rigid IRA rules with respect to deductible employee contributions. Application of the IRA rules in lieu of the well-established rules governing qualified plans would create an enormous communications probem.

Mr. Chairman, on behalf of the 75,000 employees and NADART, we strongly endorse S. 3288 and urge immediate enactment of this bill.

Thank you.

Senator PACKWOOD. Mr. Troll?

STATEMENT OF RAYMOND C. TROLL, SECRETARY AND GENERAL COUNSEL, GATES LEARJET CORP.

Mr. TROLL. I am Ray Troll, secretary and general counsel of Gates Learjet Corp. in Wichita and I am pleased to have this opportunity to appear before you today to present the views of my company in support of S. 3288.

If enacted, this bill would do much to relieve the critical problem our company now faces; also because that problem is immediate and acute—and becoming more acute—we urge your early favorable action on this bill.

Unless that bill is enacted, the efforts of our company to provide adequate pensions for all of our employees will be frustrated as to a certain group of them, and I refer to our engineers, who, because of the nature of our business, comprise a significant part of our labor force and who are absolutely essential to the continued development and production of our aircraft.

We are particularly concerned about the current state of the tax law which we believe is the primary cause of these difficulties, and I will try briefly to explain it.

The company maintains a noncontributory pension plan for our employees with an optional voluntary contributory provision, which permits the employees to elect to contribute from 2 to 10 percent of their W-2 earnings.

Such voluntary contributions are, of course, not tax deductible. Our retirement plan is a defined benefit plan which provides a certain percentage of the employee's final average compensation for each year of service. The employee is fully vested in this pension after 10 years of service.

Although most of our employees are adequately covered under the plan, many of our engineers tend to move from job to job and frequently leave our employment before vesting and, for this reason under present law, these engineers are unable to build pension benefits under our basic company-funded plan, and also their interest in the contributory feature of the plan has been virtually nil.

Being covered under the plan, they cannot contribute to an IRA, and therein lies the nub of the problem. Many of them argue very vehemently that coverage under the plan should be made discretionary so that they could reject the coverage and establish IRA's but, as mentioned later, this is certainly not feasible. And, as a consequence, we find that morale among this professional group of employees has been hurt seriously.

Also, it adversely affects our ability to hire needed personnel. Right now, we have urgent, unfilled requirements for engineers, especially for those who are specialists in aircraft design, aerodynamics, stress, and several other specialized fields in engineering.

As a result, we have had to contract out much engineering work simply because of our inability to hire directly the needed engineering expertise.

And, as you might expect, such contracting out has significantly compounded the problem, because the use of engineers under contract to these technical service firms makes our engineering staff even more transitory in nature. In fact, we have noted a trend toward nomadism in the engineering profession—that is a good word. I looked it up the other day.

As I mentioned, it has been argued that we should permit voluntary participation in our defined benefit plan, but that is totally unacceptable because it would subject the plan to the risk of loss of its tax-qualified status. We have discussed with our engineers the underlying concepts of S. 3288 and from their responses we are convinced it would very substantially alleviate the situation.

S. 3288 would go a long way in solving the morale problem of our engineers and would certainly enhance our ability to attract to our company as permanent professional employees the additional engineering talent we so urgently need.

I admit that this statement reflects only our problem. However, we believe it fairly typifies a personnel problem being experienced in other firms, particularly those who must, as in the aerospace industry, rely so heavily upon highly trained professional people.

Accordingly, we believe the bill is not only good for our company, but good national policy and recommend its enactment.

Thank you.

Senator PACKWOOD. Who is next?

Mr. HAND. Mr. Hand.

Senator PACKWOOD. Do you realize there is about 30 seconds left for the other two presentations?

Mr. HAND. I realize that.

Senator PACKWOOD. As I understand, you gentlemen were told ahead of time about the 15-minute limit on the presentation in chief, is that right?

Mr. HAND. We were told; yes, sir.

STATEMENT OF WILLIAM HAND, PRESIDENT, HAND & ASSOCIATES

Mr. HAND. Mr. Chairman, I will try to keep mine to about 15 seconds, so we will split it.

My name is William W. Hand. I am president of Hand & Associates of Houston, Tex., and I am also cochairman of the legislative committee for the American Society of Pension Actuaries.

We are appearing to urge this committee to report favorably on Senate bill 3288 and I have prepared a written statement for the record.

Senator PACKWOOD. Mr. Phillips?

STATEMENT OF ROBERT C. PHILLIPS, DIRECTOR, VICE PRESIDENT, AND CHIEF ACTUARY, TOWERS, PERRINS, FORSTER & CROSBY

Mr. PHILLIPS. Mr. Chairman, my name is Robert C. Phillips. I am a director and vice president of Towers, Perrins, Forster & Crosby and also the firm's chief actuary. My purpose in appearing before your committee is to express my support and the support of my firm for this bill. Being an actuary, I would like to comment upon certain of the actuarial aspects of this bill, and I have raised three questions in my testimony which I hope will form part of the record.

We believe—to go right to the summary—that this bill will reverse the trend of plan terminations started by ERISA and lead to the establishment of new plans, increased coverage of average and low-earnings employees, and improvement of existing plans.

Senator PACKWOOD. Mr. Schoeneman was given 1 extra minute or 2 outside of the 15-minute panel.

Mr. Schoeneman?

STATEMENT OF CHARLES W. SCHOENEMAN, BUREAU OF SALESMEN'S NATIONAL ASSOCIATIONS

Mr. SCHOENEMAN. Mr. Chairman, my name is Charles Schoeneman. I am Washington counsel for the Bureau of Salesmen's National Associations and I am here today on behalf of their two affiliates, the NAWCAS Guild and the National Association of Men's and Boys' Apparel Clubs. These are the dominant traveling salesmen's association in the apparel industry and their members are entitled to membership in the wholesale apparel salesman's local of district 65, distributive workers of America, a labor organization which maintains a group pension trust for the salesman's benefit and represents them in certain collective-bargaining respects.

The members of NAWCAS and NAMBAC strongly support this bill—S. 3288—introduced by Senator Dole on July 13, and he deserves our congratulations for recognizing the needs of the traveling salesman and those needs that have been overlooked largely by reason of the thrust and effects of ERISA. This bill goes a long way in solving one of the most complex problems confronting salesmen—the lack of any tax deduction for their contribution to their pension plan.

For one reason or another, they have generally been unable to participate in their company's plans and, for reasons alluded to earlier, ERISA has proved to, at best, been a mixed blessing. The plan has, in effect, been hurt by ERISA as my full statement points out.

This particular plan first of all is financed exclusively by contributions made by union members associated with NAWCAS—NAMBAC. No employer contributes a penny to the trust.

Second, all contributions made by the participants to the trust as 100 percent nonforfeitable.

Third, the trust provides certain task service and disability pension benefits which we, of course, far exceed what is available to them under IRA plans marketed commercially.

Fourth, the union district 65 stands behind the benefits promised by the trust.

The inavailability of a tax deduction was not really a problem until ERISA was passed and, of course, as again has been alluded to, the effect of ERISA competitively has been to damage the existing trust and to encourage members to withdraw, a trend which we hope has been reversed.

I would like to emphasize, in closing, that traveling salesmen generally do not understand why it is that if they put their money into an account run by a bank or an insurance company they can get a tax deduction but if they put their money in a union pension fund which provides superior benefits, in most instances to that provided by any IRA, they cannot get a deduction.

This, they fear, is unfair tax discrimination.

S. 3288 and S. 3017, the Williams-Javits bill, are the only bills presently pending in Congress to amend the code to allow a retirement savings deduction for persons contributing to either an employer or union-sponsored pension plan, such as the salesman's pension trust I described. We believe the objectives of both bills are sound and that they would protect both employer and union pension plans from being undercut by IRA's and because they would promote a greater expansion of private pension coverage to the United States.

The distinguishing characteristics of these bills, therefore, is that they provide an even-handed treatment in that both management and labor would benefit from them.

As currently drafted, we prefer the S. 3288 approach because it does not have a limitation which we feel unfairly penalizes the successful salesman. Finally, let me reiterate how encouraged we are that this committee is holding these hearings, that through the efforts of Senators like Senators Dole, Williams, and Javits and others, something now, at long last, is being done to provide what appears to be on a bipartisan basis, fair tax treatment for the salesman's pension trust and many other pension trusts, both union sponsored and employer sponsored, that need this protection.

Thank you very much.

Senator PACKWOOD. Senator Dole?

Senator DOLE. Because of the time I do not have any questions. I would just say that I did a survey in my State of Kansas and, as Mr. Troll has pointed out, there has been a very high incidence of plan termination. I assume that this is true all across the country. How many engineers do you employ?

Mr. TROLL. We have approximately 150 at the present time, Senator. Those are degreed people, people with bachelor's or master's degrees.

Senator DOLE. The plans are terminating for a reason. I think those reasons have been pointed out with some clarity this morning. I think S. 2462 and S. 3288 are compatible. I do not think they are mutually exclusive.

Particularly with reference to S. 3288, it has not been introduced for very long, but there is support for it. We hope to pick up additional support. I had a chance to visit with some of the Representatives who were here last week.

With reference to S. 2462, there was a lot of support for this on the House side in the 1976 Tax Reform Act. There was not a great deal of sentiment on the Senate side. I think it is fair to say that there is now bipartisan support. I would hope that Treasury will be able to accommodate us. I know Treasury is opposed to both bills, but they support them in principle.

It would indicate to me that there might be some room to work out an arrangement.

I think you have covered the basic points. I might want to submit questions to you, Mr. McCormick, providing you could furnish answers for the record. Would that be satisfactory?

Mr. MCCORMICK. Quite so, sir.

Senator DOLE. That would save us time.

Mr. MCCORMICK. I hope we find out Treasury's attitude on the matter, too.

Senator DOLE. Are they going to submit their views in writing?

Senator PACKWOOD. No; Treasury will comment now.

Mr. SAMUELS. I will comment briefly now. We have asked that the record be kept open and we will submit a full written testimony as soon as it is prepared.

As Treasury has indicated in previous testimony on a similar bill, S. 3140, introduced by Senator Bentsen, we believe there may be some merit in the principle of allowing a deduction for employee contributions to a qualified plan, provided actual participation in the plan is nondiscriminatory.

We believe, however, the subject of 3288 should be considered only in connection with salary reduction arrangements which are virtually identical vehicles for deferral of income in connection with an employment relationship and after taking into full account the significant revenue implications in this bill. I think our revenue estimators are in accord with the joint committee revenue estimators and we note that there is an $877 million revenue loss in calendar year 1979.

Now, we do oppose one portion of S. 3288 and that is the portion of the bill that allows an employee to contribute to an individual retirement account, if he does not have the opportunity to contribute to a qualified plan and still get the deduction, and that is because we believe these provisions could result in discrimination against lower-paid employees.

We do support the principle of the bill, provided that actual participation in the plan is nondiscriminatory.

Senator DOLE. On that basis, you feel that we could resolve some of the differences?

Mr. SAMUELS. I think so, provided we could resolve it in connection with resolving the appropriate tax treatment for salary reduction arrangements, which I think—a salary reduction arrangement is where you have a $10,000 salary—I am sure you are familiar with them—and the employer says, would you like me to put $9,000 into a tax-deferred retirement account and you tell him yes. If the treatment on that is that the employed is not taxed on that $1,000, he has $9,000 of taxable income and $1,000 in a retirement account, or qualified plan, that is the equivalent of giving the employee $10,000 of income and allowing him a $1,000 deduction for a contribution for a qualified plan. In both places, he has $9,000 of income on which he is taxable and $1,000 in a qualified plan and we think that those problems are sufficiently related to be considered together.

Senator PACKWOOD. Any other questions?

Gentlemen, thank you.

[The prepared statements of the preceding panel follow. Oral testimony continues on p. 174.]

STATEMENT OF DEANE E. MCCORMACK, JR., CHAIRMAN, COORDINATING COMMITTEE OF THE DECQ COMMITTEE

TESTIMONY IN SUPPORT OF S. 3288 AND OPPOSED TO S. 2462

S. 3288 would permit an employee covered by a qualified retirement plan (other than a governmental plan or § 403(b) annuity) to deduct mandatory or voluntary employee contributions to the qualified retirement plan equal to the lesser of 10 percent of compensation or $1,000.

S. 2462 would permit an employee covered by a qualified retirement plan to deduct contributions to an Individual Retirement Account equal to the lesser of 15 percent of compensation or $1,500, reduced by the amount contributed on behalf of the individual to the qualified retirement plan.

The DECQ Committee Members favor S. 3288 for the following reasons:

1. The bill corrects an inequity created by ERISA.
2. The bill will reverse the trend of employees resigning from employer sponsored plans to join an IRA, thereby creating the risk that the employer-sponsored plan will lose its tax qualified status.
3. The bill will encourage employees to remain in their employer's sponsored plan which will expand coverage of retirement and incidental benefits such as death and disability benefits.
4. The bill offers an employer the opportunity to share the initial cost of establishing a tax qualified retirement plan with his employees, thereby creating the incentive to adopt new plans.
5. The bill will encourage additional retirement savings which will help relieve the burden on the Social Security system as well as increase capital available for investment.
6. The bill offers an alternative which will not add to the complexity and administrative burdens of present law because it relies on the present rules governing the qualified plans.

The DECQ Committee Members oppose S. 2462 for the following reasons:

1. The bill requires contributions to an Individual Retirement Account which

is inappropriate for an employee who may want to contribute to his employer sponsored plan.

2. The bill creates substantial administrative burdens because it requires the employer to calculate its contribution under the tax qualified retirement plan.

3. The bill is complex in all cases except the situation where the employer maintains a single individual account plan.

STATEMENT

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before you today to present the DECQ Committee's views on S. 2462 and S. 3288. The acronym "DECQ" is formed from Deductible Employee Contributions to Qualified Plans. The DECQ Committee is an association of employers who collectively represent:

The interests of its members and their 745,029 employees in seeking legislation designed to encourage the provision of adequate retirement security.

Companies ranging in size from the very small to the very large.

Various industries, including manufacturing, retailing and personal services.

The members of DECQ Committee have businesses and employees in all 50 states.

For the record, I have attached to this statement a list of the members of the DECQ Committee with the companies arranged in alphabetical order.

The tax law for a great number of years has sought to encourage the provision of pensions for the workers of this country. For several decades the income tax laws have specifically dealt with pension plans established for employees. The current state of the law is the result of a technical tax approach to a pension problem. The questions have been (1) when could the employer deduct his contribution, and (2) when was the employee taxable. That an employee would be taxable on his salary was obvious although a portion thereof might be contributed to a qualified pension plan for his later use as retirement income.

In 1962 Congress departed from strict principles of taxation. Congress provided for the Keogh plan which permits a self-employed individual to defer taxation on earned income (e.g. salary) he set aside for his retirement until the ultimate distribute as part of his retirement income.

In 1974 Congress again departed from the strict tax principles to encourage the provision of pensions by providing for the Individual Retirement Account (IRA). An IRA permits an individual to defer up to $1,500 of his salary to fund a retirement pension. In providing the IRA, Congress sought to extend the pension coverage of the private sector to individuals who were not currently covered by qualified plans or a Keogh plan.

Since Congress has seeen the wisdom of permitting an individual to set funds aside from his income today and deferred the taxation of such amounts until retirement, the provisions of S. 3288 should appeal to your sense of elementary fairness as it would permit such a deduction to individuals contributing to plans qualified under Section 401 of the Internal Revenue Code. These plans are the historical base and backbone of the private pension system.

While the IRA has been utilized by various individuals to provide for pensions, it has had effects upon existing plans that were certainly not intended by Congress. Many employees who were previously participating in their employer's qualified pension plan have terminated their participation in such plans and invested in IRAs for themselves. While this action could be beneficial from the view point of any particular individual, it generally is detrimental to the interests of the employees who wish to remain in the plan. Such resignations generally are made by the younger, lower-paid employee and can cause disqualification of the plan.

Disqualification results on the current taxation to the employee of the employer's annual contribution, if the employee's rights are vested, the loss of a deduction by the employer if the employee is not vested and the current taxation of the income of the pension trust. Needless to say, these are great burdens which frustrate the purposes of the trust without any wrongdoing by anyone.

Also, by leaving the employer's plan, the individual loses possible insurance and disability benefits often provided under the employer's plan. He also loses the opportunity to gain nonforfeitable rights in accordance with the vesting formula of the plan and additional benefits the employer may provide in the future for prior years of plan participation.

S. 3288 would correct these deficiencies by providing a deduction to the employee for his contribution to the employer's plan. He would be immediately vested in these contributions and his motivation to resign from the employer's plan for the immediate advantage of the tax deduction available in an IRA would not be attractive. Under S. 3288 the employee would not only gain a deduction for his mandatory or voluntary contributions to the employer's plan but would tend to gain all of the additional benefits provided under the employer's plan.

S. 3288 provides an employee a deduction up to the lesser of 10 percent of pay or $1,000 for his contribution to a qualified plan maintained by his employer. To the extent that the employee's contribution does not exceed this limit, the source of funding the pension is irrelevant from a tax viewpoint of the employee. While today there is an IRA-related resistance on the part of the employees to conrtibute to a plan, this resistance would be substantially lessened with the enactment of S. 3288. Congress would in fact free an additional source of funds to provide for pensions for the private sector employees. This source could be utilized together with the employer's contribution to provide pensions in areas where no plan currently exists.

The small employer is typical of this group. His costs are critical. His profit may be marginal. The employer must hold down his costs if his product is highly cost sensitive. Many of these employer's feel that they cannot undertake to provide totally for the employee's pension.

In addition, many employers cannot readily pass on increased pension costs to the customer in the form of higher prices. The current state of law favors the employee in enterprises where the product is not cost sensitive, that is, where the cost can be readily passed on to the customer or where employment costs are a relatively insignificant part of the total cost of the product.

However, if S. 3288 is enacted the employer could more freely ask his employees to participate in funding the pensions since they would be funding on an equal basis in which the tax would be deferred until the retirement of the individual employee commences. We believe that many employers would not only establish new plans to cover employees who currently are without any retirement protection other than Social Security, but that many employers would add to their existing plans to provide more adequate benefits.

Clearly it can be expected that the enactment of S. 3288 would add significantly in the form of retirement savings to the capital available for investment in this country. This capital would not only provide badly needed dollars for the current capital needs for our Nation but would also contribute directly to the retirement needs of many additional people both in number of employees covered and the number of employees covered adequately. To the extent that these efforts are successful, Congress will not have to further increase Social Security coverage as the private sector will become more able to take care of itself. This alone has great significance to the overall funding requirements of our Federal budget.

Of prime importance to any legislation is whether it adds to the complexity and the administrative burdens of existing law. S. 3288 would not add to the existing burdens of employers or the IRS. It could be administered simply and efficiently. For example, the question of how to confirm to the employee and to the IRS that the employee is entitled to a deduction from gross income is handled within the existing tax reporting structure. The employer already has to provide each employee every year with a Form W2 on which he reports the individual's earnings. There are squares on this form in which the employer could add the amount of the employee's deductible contribution to a qualified plan and thus affirm to both the employee and the IRS the employee's entitlement to a deduction. Secondly, the employer currently is required to inform the employee when pension payments commence the amount which is subject to tax. The amount that the employee has contributed to the plan and deducted would simply be added to any employer contributions made on the employee's behalf, and the total would be taxable at the time retirement payments to the employee commence. Thus, for this purpose, the deductible employee contribution simply would be treated as an additional employer contribution.

Additionally, we believe S. 3288 represents the best conceptual approach to solving the problem of pension funding for additional pension benefits. First, S. 3288 operates within the framework of a qualified plan. Qualified plans have a long and proven history in the private sector. They take many forms, for instance, defined benefit pension plans, defined contribution plans, thrift-savings plans, defined profit sharing plans, etc. Each of these types has a definite purpose to serve and current law permits maximum flexibility. As a consequence, different employee and employer arrangements can utilize the type of plan that is best suited to such arrangements, rather than have to conform to a single pattern.

The approach of S. 3288 also is preferable to the general LERA concepts that have been the subject of other bills. A major deficiency of the LERA concept which is represented in S. 2462 and other bills, is that it requires that a determination be made of how much an employer has contributed on an employee's behalf in order to limit the amount that the employee contribute. This determination can be made under a single defined contribution plan, but is extremely complex for defined benefit plans or situations such as those which involve an employee who works for two employers, or is covered under a multi-employer plan. Attempts to solve this problem have often turned to an assumption that an employer contributes a stated percentage of the employee's compensation on the employee's behalf. As is true of any arbitrary assumption, some employees will gain an advantage while others will be treated unfavorably. S. 3288 avoids this problem by reducing to $1,000 the maximum amount that can be contributed on a tax deductible basis by an employee. This is $500 less than the amount an employee could contribute if he participates in an IRA. This reduction is insignificant, however, because it enables the ordinary worker to increase significantly his pension provision while maintaining simplicity in the law.

For the foregoing reasons, we urge your support for S. 3288.

DECO SPONSORS

American Bank & Trust Co., Baton Rouge, La.
American Express Co., New York, N.Y.
Bankers Life & Casualty Co., Chicago, Ill.
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G. H. Bass & Co., Wilton, Maine.
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Bibb Co., Macon, Ga.
Blue Bell Inc., Greensboro, N.C.
Booke & Co., Winston-Salem, N.C.
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Chevy Chase Cars, Inc., Bethesda, Md.
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Loxco Inc., Iberia, La.
MAR, Inc., Rockville, Md.
MacDermid, Inc., Waterbury, Conn.
Martin Tractor Co., Inc., Topeka, Kans.
Maui Varieties, Ltd., Honolulu, Hawaii.
Mercedes-Benz of North America, Inc., Montvale, N.J.
Merichem Co., Houston, Tex.
Milliman & Robertson, Inc., Seattle, Wash.
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North Electric Co., Laurel, Miss.
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Pacific Scientific Co., City of Commerce, Calif.
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Spartanburg Herald-Journal, Spartanburg S.C.
State National Bank of Connecticut, Bridgeport, Conn.
State Street Boston Corp., Boston, Mass.
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United States Gypsum, Co., Chicago, Ill.
Utah Professional Review Organization, Salt Lake City, Utah.
Varian Associates, Inc., Palo Alto, Calif.
Waldman Corp., Parsippany, N.J.
Woodbury & Co., Inc., Worcester, Mass.
Zurich-American Insurance Co., Chicago, Ill.
Zurn Industries, Inc., Erie, Pa.

Statement of the National Automobile Dealers and Associates Retirement Trust

My name is Joseph S. Parren. I am Director of the National Automobile Dealers and Associates Retirement Trust. Accompanying me today is Mr. Richard B. Taylor, Assistant Director—Compliance.

The National Automobile Dealers and Associates Retirement Trust (NADART) appreciates the opportunity to present to the Subcommittee its comments on S. 3288, a bill which would solve one of the major problems facing small employers, such as automobile dealerships, who maintain qualified retirement plans.

Because required employee contributions to a qualified contributory retirement plan and voluntary contributions to a non-contributory plan are not tax deductible, individuals presently have an incentive to drop out of such plans to establish Individual Retirement Accounts (IRA's) where their contributions are tax deductible. S. 3288 would eliminate this incentive by permitting employees belonging to an employer's qualified plan to deduct their own contributions to these plans.

For the reasons set forth below, NADART would strongly urge the passage by the Congress of this measure.

NADART is the sponsor/plan administrator of four Master Plans approved by the Internal Revenue Service. Members may join one or more of the

Master Plans sponsored by NADART. Currently, NADART administers over 5,300 retirement plans covering in excess of 75,000 employee participants. The dealers who have joined one of NADART's Master Plans are located throughout the United States. During the twenty-one years that NADART has sponsored the Master Plans, there has been a tremendous increase in the number of dealers who have adopted one of NADART's Master Plans. The Master Plans have been successful because a dealer is able to adopt and maintain a retirement plan at a fraction of the cost of an individually designed plan. Furthermore, the Master Plans provide for an array of plan provisions that permits the dealer to retain the flexibility of an individually designed plan.

In general the dealer who adopts one of NADART's Master Plans employs fewer than twenty employees.

Generally, the financial position of the dealer does not permit him to maintain the plan without seeking to share the cost with his employees by requiring their contributions. Accordingly, a substantial percentage of the Master Plans adopted by the dealers require employee contributions to participate in the plan (contributory plan).

In order for the dealer to establish and maintain a tax-qualified contributory plan, the dealer must demonstrate that a fair cross-section of the employees at all income levels elect to participate in the plan at all times. In other words, the dealer must demonstrate that high, middle and low paid employees will contribute under the Master Plans at all times.

It is with respect to this requirement that NADART srongly urges the Congress to adopt S. 3288. This bill will eliminate the prejudice which presently exists against contributory plans.

The Employee Retirement Income Security Act of 1974 (ERISA) permits certain employees to use pre-tax dollars to fund a retirement benefit by deducting contributions to an Individual Retirement Account (IRA). Employees who are covered under a tax-qualified plan are not, however, allowed to participate in an IRA. Because of this limitation, a number of the participants in the contributory Master Plans have elected to withdraw from the Master Plan in order to participate in an IRA. The deductibility of the individual's contribution appears to attract them away from the employer's plan.

The ramifications of the trend to elect-out of the contributor plan are very serious for NADART and its Master Plans. As previously stated, the dealer must be able to demonstrate that a fair cross-section of his employees participate in the plan at all times in order to retain the tax-qualified status of the plan. Many of the participants who elect-out of the Master Plans are lower paid rank and file employees. As these employees withdraw from the plan, the employer's ability to demonstrate that a fair cross-section of employees participate diminishes. When the employer is unable to demonstrate that a fair cross-section of his employees participate in the plan, the tax-qualified status of the plan is lost.

If this occurs, the employees will be subject to income tax on the employer's contribution under the plan to the extent the employee is vested in that contribution, the employer is unable to claim its deduction for such contribution to the extent the employee is not vested, and the income earned on assets held under the plan will be subject to income tax. In addition, the employee will lose the incidental tax benefits such as the favorable tax treatment on lump sum distributions and the estate tax exclusion.

Because many of the dealers in NADART's Master Plans have fewer than twenty employees, withdrawal of one employee has a significant impact on the employer's ability to maintain tax-qualified status. Particularly for the dealer who desires to adopt a contributory Master Plan, the failure to enroll several employees will severely restrict his ability to demonstrate that a fair cross-section of employees will participate.

For these reasons, NADART stands in favor of providing a deduction to the employee for his contributions to a tax-qualified retirement plan.

In our position as plan administrator for over 5,300 retirement plans, we believe that S. 3288 offers the best approach to solve the problems which we face today. Unlike other bills, such as S. 2462, which attempt to deal with the problems created by the adoption of the IRA provision, S. 3288 does not require the complicated computation of the employer's contribution under the plan. The participant is permitted to contribute ten percent or $1,000 without regard to the employer contribution made on his behalf. This will simplify our procedure in administering the deduction for employee contributions. Indeed, S. 3288 in its present form requires NADART to take only one additional step, which is to inform the employee how much of his contribution is deductible.

Another significant difference in the approach of S. 3288 to other bills addressing the problem is that S. 3288 relies on the well-established rules governing tax-qualified retirement plans. Many of the other bills would require the application of the rigid IRA rules with respect to deductible employee contributions. Application of the IRA rules in lieu of the well-established rules governing qualified plans would add complexity and create enormous communication problems.

For the reasons stated above, NADART strongly endorses S. 3288 and urges immediate enactment of this bill.

I appreciate the opportunity to comment upon this proposed legislation on behalf of NADART and will be happy at this time to respond to any questions you may have.

Thank you.

STATEMENT OF WILLIAM W. HAND, CO-CHAIRMAN OF THE LEGISLATIVE COMMITTEE, AMERICAN SOCIETY OF PENSION ACTUARIES

SUMMARY

Testimony in support of S. 3288.

S. 3288 would permit an employee covered by a qualified retirement plan (other than a governmental plan or § 403(b) annuity) to deduct mandatory or voluntary employee contributions to the qualified retirement plan equal to the lesser of 10 percent of compensation or $1,000.

The Society supports S. 3288 for the following reasons:

1. The bill will assist small employers to cope with the burdens caused by ERISA.
2. The bill will create an incentive for employers to adopt new plans.
3. The bill will re-introduce the salary reduction arrangement whereby the employer may share with his employees the initial cost of establishing a plan.

STATEMENT

My name is William W. Hand. I am the President of Hand and Associates and a Co-chairman of the Legislative Committee, American Society of Pension Actuaries. The American Society of Pension Actuaries is a national professional association of pension plan actuaries and consultants. Our 1500 members provide actuarial, consulting and administrative services to approximately 25 percent of the qualified plans in the United States. Generally, the plans for which our members perform services are small plans i.e., plans with less than 100 participants.

I am appearing before this Subcommittee to urge you to favorably report on S. 3288, a bill to provide a deduction for contributions to tax-qualified retirement plans. Our society enthusiastically endorses S. 3288 because we believe it is one of the steps which must be taken to assist employers who have felt the burdens of ERISA.

ERISA while providing many necessary safeguards, has created many burdens for employers, especially the smaller employer. It is clear that ERISA has produced a substantial increase in the cost of plan operation. In addition, ERISA created disincentives for adopting small plans such as the added recordkeeping requirements.

The future of the pension system depends on the development of employer sponsored plans because it is the best means by which to extend pension coverage. Without sufficient incentive to do otherwise, most employees will spend everything they make on a current basis and will end their productive life completely dependent on retirement income benefits from the private pension system or Social Security or both. Therefore, it is essential to stimulate growth of the tax-qualified employer sponsored plan providing for broader coverage. To achieve this goal, however, we must provide incentives to establish and maintain tax qualified plans.

There are a number of reasons that employers have decided to terminate a plan or forego the establishment of a plan. Among these reasons, probably the most significant, has been the increased cost of establishing and maintaining a plan. Pre-ERISA an employer was able to ease the initial cost impact of establishing a plan by entering into a salary reduction arrangement with his employees. Such arrangement satisfied the legal requirements for a tax qualified plan because it was non-discriminatory. In addition, under this arrangement the employee did not include in his income the contribution he made through the salary reduction agreement. Prior to the enactment of ERISA, these arrangements contributed significantly to the growth of the private pension system. Unfortunately the salary reduction arrangement cannot be entered into today because the salary which the employer contributes under the plan is taxed to the employee currently. This has severely restricted the ability of the employer to share with his employees the initial burdens of establishing and maintaining the plan.

Faced with this situation, many small employers cannot afford the initial cost impact of establishing a meaningful retirement program for their employees. For example, if the employer wishes to establish a defined benefit pension plan, the retirement program which will provide the best protection for his employees because it provides a truly determinable benefit at retirement, the cost will usually run 8 to 10 percent of payroll. In order to encourage the development of this type of plan, incentives such as that provided in S. 3288 must be established. Without this type of stimulus a plan may not be established, thus effectively depriving a large portion of our work force with this essential protection.

Enactment of S. 3288 will again permit the employer and his employees to jointly establish and maintain a retirement plan. This will encourage the growth of the pension system, therefore our Society encourages the support of your Subcommittee for the enactment of S. 3288.

Thank you.

STATEMENT OF ROBERT C. PHILLIPS, DIRECTOR, VICE PRESIDENT, AND CHIEF ACTUARY, TOWERS, PERRIN, FORSTER & CROSBY, INC.

SUMMARY

Testimony in support of S. 3288, a bill to permit an employee covered under a tax-qualified retirement plan (other than a governmental plan or § 403(b) annuity) to deduct mandatory or voluntary contributions to the qualified retirement plan equal to the lesser of 10 percent of compensation or $1,000.

Towers, Perrin, Forster & Crosby, Inc. supports S. 3288 because:

1. It will enable a large sector of the work force to set aside meaningful amounts under a tax qualified retirement plan.
2. The bill may be utilized by all types of plans without additional administrative burdens.
3. The bill creates no actuarial or funding problems for employers maintaining a tax qualified plan.

STATEMENT

My purpose in appearing before your Committee this morning is to express my support, and the support of my firm, for enactment of S. 3288. Being an actuary, I would like to comment on certain of the actuarial aspects of this bill, by raising and then answering three basic questions concerning its provisions.

1. Would S. 3288 enable employees to set aside meaningful amounts under qualified pension plans to help provide for their retirement security?

The answer is "yes" for the lower-paid employees, "maybe" for those in the middle income brackets and probably "no" for the higher-paid. For employees currently earning the national average wage of approximately $10,000 annually, savings of $1,000 per year for 30 years will provide a pension benefit of approximately 20 percent of final pay, assuming such savings accumulate at an interest rate of 6 percent per year and his future pay increase average about 5 percent annually. When this 20 percent benefit is added to a Social Security pension which (under current law) can be expected to be about 40 percent of this employee's final pay, the total estimated pension level is 60 percent of final pay before considering any additional benefits the employee may be eligible for as a result of employer contributions to a qualified plan on his behalf.

Naturally, the $1,000 lid on deductible employee contributions causes a sharp decrease in the employee's pension as a percentage of pay as an employee's pay increases. Using the same assumptions used for the example of an employee who earns $10,000 annually, an employee who earns $30,000 annually would accumulate a pension equal to approximately 29 percent of his final pay—7 percent from his retirement savings deduction under S. 3288 and 22 percent from Social Security. Clearly, Social Security and the pension derived from deductible employee contributions are insufficient to provide adequate income continuance after retirement for medium and higher paid employees. Higher private plan benefits are required if the reasonable retirement needs of these employees are to be met. Nevertheless, S. 3288 would enable these groups to accrue meaningful amounts of supplemental pension benefits.

2. Can both of the basic kinds of pension plans—defined benefit and defined contribution plans—be amended to offer employees the advantages of the bill's provisions?

The pension supplementation arrangement proposed in S. 3288 is simple and voluntary. It would be relatively easy for employers to amend any qualified pension plan—whether it is of the fixed benefit or fixed contribution variety—to include a provision permitting employee contributions. This is an important point because many employers and consultants have concluded that fixed contribution plans are superior to fixed benefit plans solely because ERISA imposes fewer burdens on the former type of plans. For most employees, however, fixed benefit plans are preferable. Such plans give employees assurance that they will receive a predeterminable pension benefit, whereas fixed contribution plans simply create individual employee funds which are applied at each employee's retirement age to provide whatever pension benefit can then be obtained by such funds. In effect, the fixed contribution plan shifts the risks inherent in funding and investment yield variances from the employer to the employee. Unlike certain other proposals, this bill would not further discriminate against fixed benefit plans.

S. 3288 also would make it relatively simple for an employer who currently does not maintain a qualified pension plan to establish such a plan for his employees. If despite this simplicity, an employer does not incorporate provisions allowing for employee contributions in his plan or does not permit employee contributions to his plan up to the S. 3288 deduction limit, his employees easily can establish IRAs to enable them to take full advantage of the S. 3288 deduction limit.

The simplicity of this proposal, ease of accommodation by qualified plans, and flexibility of possible arrangements are three distinct advantages S. 3288 offers over certain alternative proposals. One such proposal would involve the imposition of complex IRA rules on existing rules applicable to qualified plans, while another would compel employers to amend their plans to permit employees to make deductible contributions. Other proposals involve other potential disadvantages which are avoided under S. 3288.

3. Would the bill create any actuarial or funding problems for employers with private pension plans?

The answer to this question is an unequivocal "no". The proposed arrangement for permitting limited deductibility of employee contributions to qualified plans is simple, easy to communicate and administer, self-funding, and devoid of actuarial complexity.

We are pleased to join the many other groups which have expressed support for this legislation.

STATEMENT OF CHARLES W. SCHOENEMAN, LEGISLATIVE REPRESENTATIVE, BUREAU OF SALESMEN'S NATIONAL ASSOCIATIONS, ON BEHALF OF THE NATIONAL ASSOCIATION OF WOMEN'S AND CHILDREN'S APPAREL SALESMEN (NAWCAS), THE NATIONAL ASSOCIATION OF MEN'S AND BOYS' APPAREL CLUBS (NAMBAC), AND THE WHOLESALE APPAREL SALESMEN'S LOCAL OF DISTRICT 65, CONCERNING S. 3288 AND S. 2432, BILLS TO PERMIT A LIMITED INDIVIDUAL RETIREMENT DEDUCTION TO INDIVIDUALS WHO ARE PARTICIPANTS IN RETIREMENT PLANS

INTRODUCTION

My name is Charles W. Schoeneman, Legislative Representative of the Bureau of Salesmen's National Associations and I am appearing today on behalf of our affiliates, the NAWCAS Guild and the National Association of Men's and Boys' Apparel Clubs (NAMBAC). These are the dominant traveling salesmens' organizations in the apparel industry and members of both organizations are entitled to membership in the Wholesale Apparel Salesmen's Local of District 65, Distributive Workers of America, a labor organization, which maintains a group pension trust for their benefit and represents them in certain collective bargaining respects.

Members of NAWCAS and NAMBAC strongly support S. 3288, introduced by Senator Dole on July 13. Last Tuesday, July 18, the Bureau of Salesmen's National Associations sponsored a march on Washington and a rally at the West

Front of the Capitol to dramatize "Salesmen's Awareness Day" and direct attention to the traveling salesmen's need for availability of affordable gasoline and large automobiles or recreational vehicles to carry on their business, to their opposition to limit tax deductions for business meals, and, most importantly, in support of tax deductions for their contributions to their pension plan. Close to 1,000 salesmen representatives from 33 States participated in the march and it received nationwide publicity. We believe that the march has fulfilled its purpose in acquainting the Congress with some acute problems faced by traveling salesmen. But we know that it is not enough to march and demonstrate and meet with our Congressional representatives. We also have to give active and continuing support to those who have recognized our needs and have fashioned practical legislative proposals to deal with them. We, therefore, wish to commend Senator Dole for introducing S. 3288, a bill which goes a very long way in solving one of the most perplexing problems confronted by salesmen—the lack of a limited tax deduction for their contributions to their pension plan.

The salesmen's pension problem

For one reason or another, traveling salespersons have generally been unable to participate in their company's pension or profit-sharing plan. In order to systematically provide for his or her retirement security, the traveling salesperson, therefore, has few choices. He or she may obtain the limited retirement benefits of an Individual Retirement Account (IRA) which permits a federal income tax deduction of up to the lesser of 15 percent of earned income or $1,500 per year, or, where feasible, participate in an H.R. 10 plan with an annual federal income tax deduction equivalent to the lesser of 15 percent of earned income or $7,500.

The salesperson's boss, who is the owner of the firm, qualifies under current tax definitions as a corporate employee and thereby may enjoy really meaningful defined contribution retirement benefits encouraged by an annual federal income tax deduction of 25 percent of earned income up to $25,000. However, this patent inequity in the disparity of deductions is not our principal complaint. The vast majority of our members could not take advantage of the superior deduction if it were, in fact, available.

Our problem results from the very limited benefits that are available under the tax deductible, commercial, custodial plans. To properly protect ourselves and our families, almost 3,000 wholesale apparel salesmen participate in the District 65 Retirement Trust for Members of the NAWCAS Guild and the National Association of Men's and Boys' Apparel Clubs, Inc., which provides generous retirement, disability and death benefits. All contributions to this ERISA-regulated trust are voluntarily paid by the salesmen. Through legislative oversight, absolutely no federal income tax deduction is available to our members for these contributions. In effect, our members have been statutorily provided a tax decentive to properly provide for their retirement. There are several rather unique features about the salesmen's pension trust. First, it is financed exclusively by contributions made by the union members associated with NAWCAS/NAMBAC; no employer contributes a penny to the trust. Second, all contributions made by participants to the trust are 100% nonforfeitable; if a member wishes to withdraw from the trust at any time he may do so and receive all of his contributions back. Third, the trust provides certain past service and disability pension benefits which may exceed in any given case the total amount of contributions actually made by the member who qualifies for the past service or disability pension involved. In other words, the trust provides an element of social insurance which makes use of the investment gains generated by the contributions of all of the members. Fourth, District 65 stands behind the benefits promised by the trust; in the unlikely event that the asset values of the salesmen's pension trust should decline to the point that benefit payments would be jeopardized, District 65 guarantees that its funds will be used to meet these benefit commitments.

Ironically, due to long-standing IRS rulings, because members of the trust have a 100 percent nonforfeitable right to their contributions, and because membership in the trust is not a prerequisite to holding a union job, members have never been entitled to a tax deduction for their contributions to the trust as they are with respect to dues that are paid into the general funds of the union. Compare Rev. Ruling 54-190, 3 CCH Pension Plan Guide, Par. 18,023 with Rev. Ruling 72-463, 3 CCH Pension Plan Guide Par. 19,180. The unavailability of such a tax deduction, however, did not become a significant factor until the enactment of ERISA in 1974, and the popularization of the Individual Retirement Account (IRA) provisions. When the IRA provisions became effective, and banks and insurance companies began to promote them, members of the salesmen's pension trust stated or threatened to withdraw, taking their accumulated contributions with them, for the purpose of transferring them into IRA accounts where they could get a tax deduction. At the time this caused such a great concern that the trust sought to obtain a ruling from IRS that would enable the trust to qualify as a union IRA program under Section 408(c) of the Internal Revenue Code. Failing that, the trust, with the assistance of Senator Javits, then sought in July 1976, when the Tax Reform Act of 1976 was being considered, to obtain an appropriate legislative amendment to the IRA provisions in the Code. However, when later in 1976, the so-called LERA provisions of the House-passed tax reform bill were withdrawn in conference between the Senate and the House, further attempts to secure some type of IRA tax treatment for the salesmen's pension trust were aborted.

Once the legislative process appeared closed off, the trustees of the salesmen's pension trust redoubled their efforts to educate their members to the advantages of the trust. They gave special emphasis to the fact that the trust, as contrasted to IRA's, provided both past service and disability benefits and this made it quite valuable from the average member's standpoint, regardless of the availability of a tax deduction. This educational program has had a salutory effect for it appears that the members' withdrawal rate from the pension trust has diminished, but the cannibalistic competition from IRA plans merchandised by banks and insurance companies—a form of competition which could not have been intended by Congress when it passed ERISA in 1974—is a continuing threat to the pension trust's financial integrity and, just as important, its ability to attract new members.

In addition, and I'd like to emphasize this, traveling salespeople universally feel that the tax code treats them unfairly. They do not understand why it is that if they put their money in an IRA account run by a bank or an insurance company they can get a tax deduction, but if they put their money in a union pension fund, which provides superior benefits in most instances to that provided by any IRA, they cannot get a tax deduction. This, they feel, is unfair tax discrimination. Moreover, the pension trust is subject to the fiduciary and reporting and disclosure provisions of ERISA, which adds to its costs of maintenance and this intensifies the sense of being discriminated against for no valid reason. Needless to say, if Congress should enact a limited retirement deduction for employees contributing to employer plans, and make no similar provision in respect to the salesmen's pension trust, the effect would be devastating. Aside from compounding the existing unfair tax discrimination it would provide a mischief-making opportunity to unscrupulous employers seeking to build-up their own plans at the expense of the salesmen's pension trust.

Why salesmen support S. 3288

S. 3288 and S. 3017 (Williams-Javits) are the only bills presently pending in the Congress which would amend the Internal Revenue Code to allow a $1,000 retirement savings deduction for persons contributing to employer or union sponsored pension plans, such as the salesmen's pension trust. We believe the objectives of both bills are sound in that they would protect both employer and union pension plans from being undercut by IRA plans due to employee withdrawals, and because they would promote a greater expansion of private pension coverage throughout the U.S. The distinguishing characteristic of these bills is, therefore, that they provide even-handed tax treatment in that both management and labor would benefit from them.

We also believe that by expanding the amount of employee savings, these bills, if enacted, would be anti-inflationary in character, and would contribute to greater capital formation, by enlarging the pool of group pension funds available for investment. There are no more critical goals today than dampening down inflation and strengthening investment in business.

As currently drafted, we prefer S. 3288 because, unlike S. 3017, it would not phase out the $1,000 deduction when the individual earned $30,000, with the deduction being completely unavailable when the individual earned $35,000. We believe this tends to discriminate against the retirement income needs of the middle class. Also, S. 3017 appears to require a pension plan to provide for employee contributions that can qualify for the $1,000 deduction if it is to maintain its qualified status. We have reservations about the desirability of this approach as it may disrupt existing qualified plans.

As to both bills, we wish to point out that since no employer contributes to the salesman's pension trust, it is possible that the Committee in its deliberations may wish to consider whether there should be some appropriate adjustment in the treatment provided to the trust, either in terms of the amount available for deduction by the salesmen-participants or in some other manner that gives recognition to this factor.

Finally, let me reiterate how encouraged we are that this Committee is holding hearings on this subject and that, for a change, through the efforts of Senator Dole, Senators Williams and Javits, and others, something is going to be done to provide, on what should be a bipartisan basis, fair tax treatment for the salesmen's pension trust and many other pension plans that need this protection.

Senator PACKWOOD. Next we will take Neal Johnson and Thomas Herrmann.

Mr. SAMUELS. May I add for the record, Senator, that we oppose S. 2462, although we again support the principle of that bill, but because we think it would add, or cause, unwarranted administrative burdens and complexities not presented by S. 3288.

Senator DOLE. What is the revenue loss on S. 2462?

Mr. SAMUELS. I have some figures on that, if you want them. I will submit them for the record.[1]

Senator PACKWOOD. Gentlemen, I have to leave, and Senator Dole is going to take over for the remainder of the hearing.

Senator DOLE. Mr. Johnson and Mr. Herrmann—there are others at the table—I do not want to rush anyone, but we would like to finish the witness list. I am supposed to have a TV appointment at 1 o'clock. We may not be able to finish quite that soon, but your entire statement will be made a part of the record.

If you will identify the other men at the table, it will be appreciated.

Mr. JOHNSON. Yes; Senator Dole, I am happy to present Mr. Alan Bye, a member of the law firm of Webster and Chamberlain of Washington and Mr. George Webster, attorney, representative of the Sand Springs Home, Sand Springs, Okla.

Mr. HERRMANN. I am Thomas Herrmann, representing the American Association of Homes for the Aging.

STATEMENT OF NEAL JOHNSON, DIRECTOR OF THE BOARD, SAND SPRINGS HOME, SAND SPRINGS, OKLA.

Mr. JOHNSON. All right, Senator. On behalf of time—and you do not know how much I appreciate the fact that you are holding over—and the Sand Springs Home is not a new subject to any of you because I think every Member of the Senate received a letter from me, and also some information regarding the operation of the widow's colony.

Sand Springs Home was founded by the late Charles Page in 1908, long before the passage of the 16th amendment, or the enactment of an income tax. But the home was originally formed exclusively for the purpose of caring for orphans; in 1914, a widow's colony was formed to provide a place for widows to raise their children.

These activities have continued unchanged until the present time. The home has expended millions for charitable and philanthropic purposes over the years and has cared for thousands of dependent children. When it was originally formed, its founder endowed the home with assets sufficient to carry out its purposes. Fortunately, the assets have increased in value and are still sufficient to carry out his purposes. For this reason, the home has never been required to seek public support.

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[1] At press time Feb. 14, 1979 the information requested of the Treasury Department had not been received by the committee.

I might add that it was in Mr. Page's bylaws that the home could not ever solicit public funds.

Under the Tax Reform Act of 1969, restricted taxes and limitations are placed upon organizations considered to be private foundations. There are a number of exceptions to the private foundation rules, including specific exemptions and exceptions for organizations who meet the mathematical test for public support.

The Sand Spring Home does not meet public support tests, since it has never been necessary for it to seek it. Neither is it one of the organizations such as colleges, universities and hospitals, specifically exempt from private foundation requirements.

In a sense, the home provides quasi-governmental functions to the citizens of Sand Springs. Children are committed to the home by order of the Oklahoma State District Court which charges the home with the duties of care, maintenance and education of children—widows and children—who would otherwise be a burden to the State, or admitted to the widow's colony under rules and regulations promulgated by the Sand Springs Home.

The home also makes its assets available to the Sand Springs public school system. Schools and churches are allowed to use lands belonging to the home for any educational or religious purposes.

The home has paid thousands of dollars in taxes under section 3940 of the code as a private foundation. Obviously, these funds have been diverted from their charitable uses and have not been available for use by the home to benefit the dependent children and widows.

The home also experiences difficulty with the distribution requirements of section 4942 because the amounts which are required to be distributed under section 4942 are typically greater than the amounts necessary to meet the operating expenses of the home.

The disposition of the home would be set aside at least a part of the excess to provide for future contingencies and future capital needs of the home.

By its very nature, a long-term care facility such as the home must act prudently in conserving capital for needs which arise in construction of facilities in the future for housing of widows and so on.

The distribution requirements of section 4942 prevent the home from doing this by requiring the home to wastefully distribute funds in excess of amounts necessary to meet its operational expenses. Colleges, universities, and hospitals which are subject to the same long-term needs for endowment as the home, are specifically exempt from the private foundation rules and are allowed to set amounts aside for future use irrespective of the distribution requirements of section 4942.

Senate bill 2825, sponsored by our Senator Dewey Bartlett, would add long-term care facilities to the classes of organizations specifically exempt from the private foundation rule. The Sand Springs Home and other long-term care facilities are clearly in the class of organizations which should be exempt from the private foundation rule because of the specific need for long-term accumulation of endowment capital.

Further, as in the case of hospitals, colleges, and universities, long-term facilities, such as the home, are typically made responsive to the public through restrictions placed upon their operations by the State and local government.

Since the home has been founded prior to the enaction of the income tax, no claim could be made that the abuses which the 1969 Tax Reform Act sought to correct, exist. No purpose is served by the imposition of a private foundation requirement on organizations for the home.

For these reasons we urge the approval of Senate bill 2825.

In closing, I would like to call your attention to a statement made by the Treasury Department this morning. Charles Page died in 1926. Since that date to the present time, no member of the Page family has ever been a member of the administrative board of trustees of the Sand Springs Home. He did not have any children of his own; he had one adopted daughter, whom the home still cares for.

There are no members of the Page family connected with the operation. The vacancies on the board of trustees since 1926 have been filled by the Grand Master of the Masonic Lodge of the State of Oklahoma and we do not have any type of family tie-in.

So it is not a question of us keeping it together in order to enrich the family. We feel that we are spending money to make good citizens, to take care of widows and orphans, which was what Mr. Page promised his mother on her deathbed that he would do if God ever permitted him to have the money to arrange an arrangement such as he has today. And he said before he died, in 1926, that he was leaving enough tangible assets to perpetuate the Sand Springs Home if it was administrated with care.

Thank you very much.

Senator DOLE. Well, thank you very much. I understand that Senator Bartlett testified at length on this measure. I understand the Treasury Department made their views known. I appreciate your testimony and I think, based on the previous record and your statement now, I have no questions. You may be excused.

Mr. JOHNSON. Thank you.

Senator DOLE. Mr. Herrmann?

STATEMENT OF THOMAS E. HERRMANN, AMERICAN ASSOCIATION OF HOMES FOR THE AGING

Mr. HERRMANN. Senator Dole, I am Thomas Herrmann, legislative counsel for the American Association of Homes for the Aging. The American Association of Homes for the Aging represents nonprofit community-sponsored housing, homes for the aging, and health-related facilities serving the elderly throughout the United States.

About 250,000 older Americans live in over 1,500 of our member homes, which are sponsored by various religious, fraternal, foundation, labor, civic, and county organizations. The basic overriding purpose of these facilities is to provide, on a long-term basis, comprehensive spectrum of services to meet the needs of elderly persons throughout the country.

We appear before this committee today to voice our support for S. 2825, which has been introduced by Senator Bartlett. This bill will have a significant impact on several nonprofit homes for the aging throughout the country, including those in the States of Virginia, Nebraska, and Kansas.

I will summarize our statement and ask that our entire statement be included in the record.

As we understand it, the proposed legislation would reclassify homes for the aging which are presently classified as private foundations. These institutions which are serving the elderly would now be considered as public charities and not subject to the excise tax which is imposed on the net investment income of private foundations. Such exemption from private foundation rules would clearly be of benefit to these facilities which would now be able to devote a greater portion of their funds to services for elderly persons.

In enacting S. 2825, Congress would be recognizing the significance of services which homes for the aging provide to the elderly and be affording them similar tax treatment to that extended to nonprofit hospitals and other organizations providing medical care or conducting medical research.

Presently, these organizations are exempted from private foundation classification rules and are considered as public charities. In granting public charity status to hospitals and related organizations, Congress recognized the public benefit derived from these entities and their contribution to society.

We believe that Congress should also recognize the significant services provided by homes for the aging, caring for elderly persons in their declining years and the benefits to society derived from these institutions.

Thus, we request that Congress extend to the homes for the aging which are classified as private foundations the same tax treatment which is presently afforded to nonprofit hospitals and other organizations and correct the grievous inequity which exists in current law.

We recommend that the bill be refined slightly to clarify the types of organizations to which it is intended to apply. We suggest that S. 2825 be amended and that the word "shelter" be added following "long-term care." This would insure that housing would have to be a component part of the services provided by the facilities for the elderly intended to be assisted by this bill and also follow present IRS treatment of homes for the aging.

We would also suggest that the subcommittee seriously consider eliminating the limitation contained in the bill to facilities which have been operating prior to May 26, 1969. Such a provision might seriously restrict the development of new, nonprofit charitable facilities designed to care for the elderly.

By encouraging the charitable sector of our society to establish long-term care facilities which are desperately needed by our elderly population, we would be decreasing the present reliance on governmental programs for the care of the elderly.

I thank you very much.

Senator DOLE. Thank you. I have no questions. Your entire statement will be made a part of the record.

[The prepared statements of the preceding panel follow:]

STATEMENT OF THE SAND SPRINGS HOME, SAND SPRINGS, OKLA.

This statement is being submitted by the Sand Springs Home, Sand Springs, Oklahoma, to acquaint the Subcommittee with problems created by the Tax Reform Act of 1969 for certain charitable organizations. Charitable organizations engaged in the long-term care of individuals are experiencing difficulty, resulting from their classification as private foundations. For this reason, the Sand Springs Home respectfully requests this Committee to approve enaction of S. 2825.

DESCRIPTION OF THE SAND SPRINGS HOME

The Sand Springs Home was founded by the late Charles Page on June 2, 1908. On August 9, 1912, it was incorporated under the laws of the State of Oklahoma. At the time the Home was founded, there was no federal income tax since a federal income tax could not be imposed until 1913, after the passage of the Sixteenth Amendment. The Home was originally formed for the purpose of caring for orphans. In 1914, recognizing that there was a need for a facility which would provide a place for widows to raise their children, the Home also formed a Widow's Colony. These activities have continued until the present time.

Since its formation of the Home has expended in excess of twenty million dollars for charitable and philanthropic purposes and has cared for more than 800 dependent children, for whom the Home has provided all necessities of life, and more than twice this number of children and widows. There can be no doubt that the Home is carrying out its charitable purposes. The Home is unique since Mr. Page, recognizing the need for such organizations at an early date, provided the organization with the endowment which has resulted in its never having to further burden the public with requests for funds. Under the Tax Reform Act what otherwise would be considered a virtue is now a detriment, since if the Home had requested additional funds through the years from the public for its support, it would undoubtedly be able to qualify as a public foundation. By leaving the funds of the community available to be used for other charitable activities, the Home now finds itself in the position of a private foundation.

Children are committed to the Home by the order of the Oklahoma State District Court, which charges the Home with the duty of the care, maintenance and education of the children. Widows and their children are admitted to the Widow's Colony under rules and regulations authorized by the Sand Springs Home, but the children remain under the jurisdiction of their mothers.

Personal assets of children are held in trust under guardianships established under the Probate Division of the District Court of Tulsa County, Oklahoma. Individual bonded guardians are appointed by the Court, and all personal assets, including Social Security, Veterans' assets, and all increments accruing thereto, are transferred to the child when he or she reaches his or her majority. No personal funds of any child are ever co-mingled with the accounts of the Sand Springs Home. The Home's Legal Department protects each child in effecting settlement of claims for death, insurance, Society Security and Veteran's benefits from which such guardianship assets customarily accrue.

The Home makes available to the Public School System of Sand Springs and to the various churches of Sand Springs and immediate area lands belonging to it, as long as such lands are occupied and used for educational or religious purposes.

The Home's assets consist, in addition to the land and buildings directly utilized for the carrying out of the exempt activities, of large tracts of land which are increasing in value, as Tulsa, Oklahoma expands, stock in several small but prosperous wholly-owned companies [e.g., the Sand Springs Railroad Company], oil properties, and investments in governmental obligations and certificates of deposit. It is difficult to assess the total value of the assets [this being one of the problems presented by the Tax Reform Act], but the total endowment in substantial and at a minimum this value exceeds twelve million dollars.

The Home has paid thousands of dollars in taxes as required by Section 4940 of the Code. These funds have been diverted from charitable use and have not been available for use by the Home for the benefit of dependent children and widows and their children. It is submitted that the Home should not be forced to pay the tax but should be accorded the same treatment as colleges and hospitals.

The Home is also experiencing severe problems with respect to the minimum distribution requirement of Section 4942 of the Code. While Section 4942 is not a great problem to grant-making organizations which simply spend more in the form of grants to meet the distribution requirement, the Sand Springs Home and other such organizations which must meet obligations of long-term care, and have already invested considerable sums in the assets used to carry out their charitable purposes, are experiencing problems with the requirements of Section 4942. These organizations, with their continuing obligations, must be careful that overspending now does not prevent them from meeting their continuing obligations to the residents of their facilities. Not only are the general distribution requirements of Section 4942 of the Code causing problems for this type organization, but they also have difficulty meeting the private operating foundation requirements of Section 4942. In order to qualify as a private operating foundation, an organization must normally expend directly for its operating purposes an amount equal to 85% of its adjusted net income and an amount equal to not less than two-thirds of its minimum investment return. It is the second requirement, known as the "endowment test", which provides problems for the Sand Springs Home and many similarly situated homes.

The Sand Springs Home must be in a position to hold assets which will appreciate in value to insure that it will be able to meet the continuing responsibility to the children and widows for whom it has accepted responsibility. This is, of course, even more important in inflationary times. The Home must be in a position to invest for the future as well as for current income. Some would argue that the Home could simply increase its expenditure per widow or child. However, there are limits to the providing of support, and the Home should not be forced to engage in wasteful, needless spending to meet an artificial requirement of the tax laws. Profligate spending will only serve to prevent the Home from meeting its long-term charitable responsibilities. Also, it should be remembered that the Home already has its substantial investment in facilities and it is not feasible continuously to rebuild the Home.

THE PROBLEM

When the Tax Reform Act of 1969 [P.L. 91-172] was enacted, two classes of charitable organizations were created—"private foundations" and "other than private foundations." Section 509 of the Code provides the definitional provisions which govern which organizations are to be treated in one of the two respective classifications.

Prior to the Tax Reform Act of 1969, and before the substantial restrictions imposed on private foundations, there had been differences between charitable organizations but these differences involved Section 170 of the Internal Revenue Code which provided for differing limitations on the amount of deduction available to individuals who made contributions to charitable organizations.

Prior to the Tax Reform Act, there were charities that were 20 percent charities and 30 percent charities. Contributors to organizations classified as 30 percent charities under Section 170(b)(1)(A) of the Internal Revenue Code, as it provided prior to 1969, were permitted a greater maximum deduction for their contributions than was available for those contributors to organizations classified as 20 percent charities.

With the changes in the law in 1969, the former provision with respect to charitable contribution deductions was picked up and placed into the definitional provision—Section 509—which distinguished between private and other than private foundations. Thus an organization which could qualify as what was then a 30 percent—now a 50 percent—charity because of other changes in the law—would qualify as other than a private foundation. This is provided under Section 509(a)(1) of the Code. Organizations covered by this provision are colleges, universities, hospitals, and publicly supported organizations such as the Red Cross, United Fund, Boy Scouts, and other such broadly based publicly supported organizations.

Because of definitional problems that existed under Section 170(b)(1)(A) certain organizations, even though they had broad-based public support, could not be classified as Section 170(b)(1)(A)(vi) organizations because they received support in the form of membership dues rather than contributions. Into this category fell educational and scientific societies which received dues income. With respect to these organizations, since they were broadly publicly supported, there was provided in Section 501(a)(2) a means by which they could qualify as other than private foundations.

In general with respect to organizations classified under Section 509(a)(1) and 509(a)(2), there was a requirement that the organization receive more than one-third of its support from the general public, or in the case of Section 509(a)(1), be among other types of organizations listed in Section 170(b)(1)(A). With respect to 501(a)(2), there was a limitation upon the amount of investment income which could be received.

Classification under Section 509(a) (1) or (2) of the Code permits an organization to qualify as other than a private foundation and thus escape the requirements imposed on private foundations. Such organizations are not subject to taxes on investment income, nor are they subject to certain distribution requirements. The exclusion from other than private foundation status of the above referenced types of organizations was premised upon the conclusion that, given the nature of the organizations, they would not stray from the accepted paths of charitable organizations because of public scrutiny.

It was provided in Section 4942, which relates to the distribution requirements, that special status was to be given to certain private operating foundations. These are organizations that, while they cannot qualify as public foundations, engage in the operation of charitable activities. Mechanical tests were provided by which they could escape the requirements on distribution if they could establish that they met certain mathematical tests which were provided in Section 4942(j)(3).

Long-term care facilities such as the Home are comparable to schools and universities, yet are classified as private foundations under Section 509. Further, these organizations, because of their support having come from a relatively few individuals, may not escape being classified as private foundations by meeting the public support tests of Section 509(a)(1) or 509(a)(2).

At the time of the enaction of the private foundation rules in 1969, it was determined that there were certain types of organizations as to which such rules were unnecessary. The types of organizations identified at that time as not requiring the restrictions of the private foundation rules included hospitals, colleges and universities. These organizations were placed in a separate class defined by Internal Revenue Code Section 170(b)(1)(A)(iii). This section was a wise grant of an exception to the general private foundation rules for organizations that those rules do not fit. S. 2825 would extend the same treatment to long-term care facilities.

Hospitals, universities and long-term care facilities are in the nature of operating charities. The long term fulfillment of their purposes requires the establishment of endowments upon which future capital needs may be met. The distribution rules of Section 4942 and the other private foundation rules impede such organizations in building up the capital required to insure the perpetual fulfillment of their exempt purposes. S. 2825 would change this treatment by specifying that organizations carrying on long-term care activities are not private foundations.

Churches, schools, hospitals and units of government are all treated as other than private foundations because of the functions they perform or the benefits they confer on society, rather than as a result of any artificial ratio of annual public support. Certainly, organizations which operate facilities for the long-term care of children, widows and elderly persons serve purposes equally beneficial to society and should be accorded the same status as these other organizations.

Another factor should also be considered. There are numerous other homes for children and the elderly in the United States which are operated or sponsored by churches, labor organizations and other types of organizations. By virtue of Section 509(a)(3) of the Code, these organizations are relieved of the private foundation requirements. It is submitted that the Sand Springs Home and other organizations which have been privately endowed and which care for children and the elderly should also be relieved of the requirements imposed on private foundations.

The enactment of S. 2825 would permit the funds otherwise payable as taxes or distributable under Section 4942 to be devoted to the care of the widows and children for whom the Home is responsible. It would enable the Home to set aside sufficient funds to meet its future capital requirements in order to insure that it can continue to perform its functions. It would also eliminate the uncertainties associated with qualification of such organizations as operating foundations and the complexities of computing the amount required to be distributed under Section 4942, thus releasing other assets for the exempt purposes of the organization. For these reasons the Committee is respectfully requested to act favorably on S. 2825.

Statement of Thomas E. Herrmann, Legislative Counsel for Public Policy of the American Association of Homes for the Aging

Mr. Chairman, I am Thomas E. Herrmann, Legislative Counsel for the American Association of Homes for the Aging. Accompanying me is Laurence F. Lane, our Director for Public Policy.

The American Association of Homes for the Aging (AAHA) represents nonprofit community-sponsored housing, homes for the aging, and health-related facilities serving the elderly throughout the United States. About 250,000 older Americans live in over 1,500 AAHA member homes, which are sponsored by various religious, fraternal, foundation, labor, civic and county organizations. The basic, over-riding purpose of these facilities is to provide, on a long-term basis, a comprehensive spectrum of services to meet the needs of elderly persons in our society. A special emphasis is placed on the social components of care, which involves providing for the social, psychological, and spiritual, as well as physical needs of older persons. Thus, in offering a wide range of services and living arrangements for elderly persons, ranging from skilled nursing to independent living, nonprofit homes for the aging serve a vital role in communities throughout the country.

We appear before this Subcommittee today to voice our support for S. 2825, which has been introduced by Senator Dewey Bartlett. This bill would have a significant impact on several nonprofit homes for the aging around the country.

As we understand it, the proposed legislation would reclassify homes for the aging which are presently classified as private foundations under I.R.C. § 509(a) (1). These institutions which are serving the elderly would now be considered as public charities and not subject to the excise tax which is imposed on the net investment income of private foundations. Such exemption from private foundation rules would clearly be of benefit to these facilities which would now be able to devote a greater portion of their funds to services for elderly persons.

In enacting S. 2825, Congress would be recognizing the significant services which homes for the aging provide to the elderly, and be affording them similar tax treatment to that extended to nonprofit hospitals, and other organizations providing medical care or conducting medical research. Presently, these organizations are exempted from private foundation classification and rules and are considered as public charities. In granting "public charity" status to hospitals and related organizations, Congress recognized the public benefit derived from these entities and their contributions to society. We believe that Congress should also recognize the significant services provided by homes for the aging in caring for elderly persons in their declining years and the benefits which society derives from these institutions. Thus, we request that Congress extend to homes for the aging which are classified as private foundations the same tax treatment which is presently afforded to nonprofit hospitals and other organizations, and correct the grievous inequity which exists in current law by enacting S. 2825.

We recommend that the bill be refined slightly to clarify the type of organization to which it is intended to apply. We suggest that S. 2825 be amended and the word "shelter" be added following "long-term care." This would insure that housing would have to be a component part of the services provided by the facilities for the elderly intended to be assisted by this bill and follow present Internal Revenue Service treatment of homes for the aging.

We would also suggest that the Subcommittee seriously consider eliminating the limitation contained in the bill to facilities which have been operating prior to May 26, 1969. Such a provision might seriously restrict the development of new, nonprofit, charitable facilities designed to care for the elderly. By encouraging the charitable sector of our society to establish long term care facilities, which are desperately needed by our elderly population, we would be decreasing the present reliance on governmental programs for care of the elderly.

The concept of homes for the aging serving the needs of our elderly population was developed by the private, voluntary, nonprofit sector of our society. Homes for the aging were first established in America through the charitable motivations of concerned individuals who recognized the necessity to provide for the needs of our elderly population, which were not recognized by existing governmental programs. Thus, through charitable contributions, homes for the aging were developed to provide housing, health care and financial security to elderly persons.

Following the enactment of the Tax Reform Act of 1969, some homes for the aging were classified as private foundations. They were classified as such because, even though they were considered as tax exempt under Section 501(c) (3) of the Internal Revenue Code, they did not fall within the so-called "50 percent organizations" described in Internal Revenue Code 170(b) (1) (A), and their investment income constituted a substantial part of their support. Because of this classification, these homes for the aging are subject to a 4 percent excise tax on net investment income. Thus, these facilities are treated under our current tax laws exactly the same as private grant-giving foundations, notwithstanding the fact that their funds are expended for, and devoted to, the care of their elderly residents. Since 1969, AAHA protested this inequity in tax treatment.

Under existing law, in order to qualify as a private operating foundation, an organization must expend directly for the active conduct of its exempt activities (i.e., care of the elderly) at least 85 percent of its adjusted net income. Additionally, it must either devote 65 percent of its assets (not including investment assets), directly to its exempt activities or make payments directly for the active conduct of its exempt activities in an amount which is not less than two-thirds of its minimum investment return (3.333 percent). [Section 4943(j)(3)(B)(1)]. In enacting these requirements, Congress sought to insure that organizations seeking classification as private operating foundations applied a significant amount of their assets and income directly for the performance of their exempt function.

It should also be noted that all nonprofit homes for the aging in order to obtain 501(c)(3) tax status, must conform to the requirements of the Internal Revenue Service, as articulated in Revenue Ruling 72-124. Under this Ruling, a home must provide for three basic needs of elderly persons:

1. The need for health care;
2. The need for housing; and
3. The need for financial security.

Therefore, a home for the aging has to meet several requirements in order to obtain tax exempt status.

However, in addition to the requirement that homes for the aging which are classified as private operating foundations spend substantially all of their income on their charitable activities, and provide for the three basic needs of elderly persons, Congress also provided that a 4 percent excise tax would be imposed on the net investment income of these organizations (Section 4940, Internal Revenue Code). This tax has had an extremely adverse impact on the services which homes for the aging provide to their elderly residents. As we stated in our testimony before the House Ways and Means Committee in 1973, the current law ". . . creates a curious anomaly. Many homes, which are usually our oldest, many formed over 100 years ago, which have prudently managed their funds and have been the fortunate recipients of gifts and bequests, which are now more capable of taking care of the destitute elderly than any other facilities in the United States, are really the only ones receiving a 'private foundation' classification. This is so, in spite of the fact that they meet all the other tests of being nonprofit, charitable, and not for private benefit. Thus, they are subject to all of the additional taxes and penalies of the Tax Reform Act of 1969 which then requires them to render less service to the public, take care of fewer destitute elderly, and set higher charges. The more 'charitable' our homes are, in the sense of taking care of the poor out of the private dollar rather than by the use of public funds, the more subject they are to private foundation status." The additional financial burdens placed on these organizations are totally unwarranted and need to be eliminated.

When Congress enacted the 4 percent excise tax, it did so for the express purpose of covering the cost in Internal Revenue Service administration of the tax laws pertaining to exempt organizations. The private foundations tax was viewed as taking the character of a "user fee," with the foundations incurring the burden of paying the costs for the entire exempt organization community. In its report, the House Ways and Means Committee stated that "* * * vigorous and extensive administration was needed in order to provide appropriate assurances that private foundations promptly and properly use their funds for charitable purposes." [H. Rept. 91-413 (Part 1), 91st Congress, 1st Session (1969) at 19-20]. The excise tax was imposed on all private foundations in order to curb abuses on the part of private, grant-giving foundations.

We do not think that it was ever the intent of Congress to inappropriately burden homes for the aging which are classified as private foundations and consequently force these facilities to restrict their activities in serving the elderly. Nonprofit homes for the aging which are classified as private foundations are not in the business of giving grants, and should not be treated in the same manner as other foundations. Their sole purpose is to provide for the needs of elderly persons. They bear none of the characteristics of a private foundation except, unfortunately, the burdens. And who in the end ultimately bears the burden imposed by the excise tax? It is the elderly who cannot provide for themselves. While our association recognizes and concurs in the need to eliminate abuses in the use of private foundation funds, we feel that the imposition of the 4 percent excise tax on the most charitable of homes for the aged is a most iniquitous exercise of the federal taxing power. The chief consequence of this unnecessary and unwarranted tax is the limiting of services offered to the elderly through charitable funds. Furthermore, due to this limitation being placed on programs offered to the elderly by the voluntary, private sector of society, an additional burden is placed on government-funded services and programs for the elderly, such as Medicare, Medicaid, and Section 202 subsidized housing for the elderly.

In October 1974, the Subcommittee on Foundations of the Senate Finance Committee conducted a study and issued a report which analyzed the impact of the 4 percent excise tax. The Subcommittee concluded that the tax reduced dollar-for-dollar the amount that private foundations distributed for charitable purposes. Thus, the money raised by the tax was money denied, not to private foundations, but rather to the charitable recipients of the foundation funds (i.e., the elderly). Additionally, the Subcommittee found, in reviewing the relationship between the revenue generated by the tax and the governmental costs of supervising exempt organizations, that the revenues generated by the excise tax were at least double the costs incurred by the Internal Revenue Service.

Last year the House Committee on Ways and Means held hearings on H.R. 112, a bill which would reduce the private foundation excise tax from 4 to 2 percent. In its report, the Committee concluded that "the tax produced more than twice the revenue needed to finance the operations of the Internal Revenue Service with respect to tax-exempt organizations." The Committee, in favorably reporting H.R. 112, also found that the "tax actually has reduced charitable expenditures." (H. Rep. 95–842, 95th Congress, 2d Session, 1978). We are pleased that the Senate Finance Committee has also acted favorably on this bill and hope that the entire Senate will soon take action on it. However, H.R. 112 does not completely alleviate the financial burdens imposed on nonprofit homes for the aging which are classified as private foundations; it only relieves them. We believe that S. 2825 would enable these homes to devote a much greater amount of money to their elderly residents. The services which these facilities have been able to offer to the elderly have been severely restricted because of the imposition of the 4 percent excise tax. By reclassifying these homes so that they are considered as public charities and not subject to the 4 percent excise tax, additional services could be offered and greater numbers of elderly persons assisted. As the Senate Subcommittee states in its report "* * * it is the potential recipients of foundation support, rather than the foundations themselves which bear the real burden of the excise tax." (Congressional Record, October 4, 1974.)

In considering the impact of the private foundation excise tax on the operations of homes for the aging, it is helpful to compare the amount of money generated by the tax to the cost of services and care for the elderly. Last year our Association conducted a survey of homes for the aging which were classified as private foundations. The results indicated that the average excise tax paid by a home last year was $10,239. It was also estimated that the cost for the care and maintenance of an elderly person in one of these facilities was approximately $4,223 per year. Thus, the excise tax paid by a home for the aging last year was two and one-half times greater than the average cost of providing one elderly person with medical care, housing, and other services. The dilemma illustrated by these figures is that every dollar which is paid to the government in the form of excise taxes results in less services being provided to our elderly population.

The American Association of Homes for the Aging urges favorable consideration of S. 2825. The bill recognizes that primary victims of the inequity which exists in present law are not private foundations, but rather the potential recipients of their charitable services and programs. If long term care for the elderly is going to continue to be provided by the private, voluntary, charitable sector of our society, it is imperative that this Subcommittee and Congress act affirmatively on S. 2825. By doing so, Congress would be promoting care and services for our elderly population nation-wide as well as encouraging continued charitable support for nonprofit homes for the aging. We appreciate having the opportunity to appear before this Subcommittee, and would be glad to answer any questions.

Senator DOLE. I might, before I forget it, ask that the summary of the Department's position on all of these bills, if it has not been made a part of the record, plus the cost estimates for the Joint Committee on Taxation be made a part of the record following the testimony.[1]

Thank you very much.

With reference to S. 3125, Mr. Turner will not be appearing. His statement will be made a part of the record as if given in full.

[The prepared statement of Mr. Turner follows:]

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[1] See p. 185.

Statement of Latimer Turner, Chairman of the Tax Committee, National Cattlemen's Association

Good morning, gentlemen. My name is Latimer Turner, and I am Chairman of the Taxation Committee of the National Cattlemen's Association. The NCA is a voluntary, nonprofit, nonpolitical organization representing over 280,000 cattlemen throughout the nation. Members of the Association include cattle breeders, cattle raisers and cattle marketers, many of whom are family farmers.

Background

In 1976 the NCA joined with other agricultural organizations in urging reforms in the estate tax as it affected farmland estates. The agriculture community agreed that it was essential to change the method by which farmland was valued for estate tax purposes. Prior to 1976, the law required farmland to be taxed at its "fair market value", which was taken to mean its value if put to its highest and best use. IRS agents would thus look to other tracts of land in the vicinity of a farm estate to see what the land would be worth if put to industrial, commercial, real estate or other uses and assign this value to the farm. This produced grossly inflated values for farmland estates, often bearing no relationship to the income the farm could produce, and resulted in extremely high estate taxes. Since the income the heirs of such a farm could expect to receive would be insufficient to pay the tax bill, they often had to sell all or part of it to pay the bill. This was causing the disappearance of many family farms and was forcing the conversion of farmland into non-agricultural uses which provided higher returns to pay the tax bill.

NCA and others brought this threat to the continued existence of the family farm in America to the attention of Congress in 1976. Recognizing the problem, and wanting to preserve the family farm. Congress added a new section to the Internal Revenue Code which permits farmland to be valued for estate tax purposes according to its actual use for agricultural production, rather than the market value it might have if put to some other use.

Although it is somewhat early to judge, it is our opinion that the special valuation provision is being used by many farm estates and is serving the purpose for which the provision was intended.

When Congress enacted the provision, certain restrictions and limitations were included to prevent it from being used as a loophole by speculators and shelter-seekers. One of these restrictions requires the heirs to fully repay the estate tax savings due to special valuation if the farm is sold or put to non-agricultural use within the ten-year period following death and a partial recapture during the next five-year period.

NCA Supports S. 3125

While the provision allowing special valuation for farm property is of great benefit to farmers and ranchers, the "recapture" provision poses some problems. For example, if farmland is condemned for a road, dam, airport or power line beneficiaries are required under present law to repay the tax savings to the IRS.

S. 3125 allows the beneficiaries to avoid repaying the estate tax savings to the extent that the amount received from a condemnation or other involuntary conversion is reinvested in farm property. We applaud Senator Dole for introducing this legislation and the NCA strongly supports the bill.

The bill carries through the original purpose of the special valuation provision—preservation of the family farm. Under present law, when a rancher or farmer is required to pay an estate tax by reason of his land being involuntarily converted, he has less cash to purchase comparable farmland. And, with the tremendous rise in the price of farmland in recent years, he obviously will be less able to replace the converted farm land with an equivalent amount of farmland. This obviously results in an erosion of the family farm.

Other Recommendations

Before concluding, I would also like to briefly point out some other problem areas relating to the special valuation provision which we believe Congress should address.

First, there is a $500,000 limit on the amount by which the special valuation can reduce the fair market value of the gross estate.

By imposing a $500,000 limitation on this provision, the benefits of the provision are significantly limited. With the growth in size of family-owned agricultural operations, and the historic pattern of increasing farmland values, the $500,000 limitation severely and unnecessarily restricts the intended beneficial effect of the special use valuation provision.

NCA recommends elimination of the $500,000 limitation

The 15-year recapture period currently provided for in Section 2032A is excessive and is not needed to deter speculation or assure retention in the family of the farmland and continuation of the family operation. Moreover, a 15-year recapture period may unfairly tie the hands of the surviving family in disposing of the land for legitimate business reasons. For example, during drought conditions, such as presently being experienced, it can be necessary to sell some land and acquire other land in another region not affected by the drought. The 15-year recapture period could also unfairly create title and loan problems by virtue of the lien which would be on the property throughout this period.

Consequently, NCA recommends that the recapture period be reduced to five years, with 100-percent recapture of the tax during such period.

Finally, there is a serious problem with the "material participation" requirement. Presently, there is a requirement that in order to elect to use the special valuation provision, the decedent or a member of his family must have materially participated in the farm operation in five out of eight years immediately preceding the decedent's death. A similar requirement is applied to the qualified heir who inherits the farm. Whether or not there has been material participation by an individual is to be determined in a manner similar to the manner in which material participation is determined for purposes of the tax on self-employment income with respect to the production of agricultural or horticultural commodities.

A major problem with the pre-death material participation requirement is that farmers and ranchers who "materially participate" in the operation of all or a significant portion of their farm or ranch may be subjected to self-employment tax on the earnings from the business and also might forfeit social security benefits to which they would otherwise be entitled. The result is that, in many cases, farmers and ranchers will be forced to decide whether they want the benefits of farmland valuation for their estates or whether they would rather receive full social security benefits and not be subject to self-employment tax on certain of their farm earnings during their lifetimes. It seems unfair to force this choice on farmers and ranchers and certainly this was not the intent of the farmland valuation provision.

Accordingly, NCA recommends that the material participation test be changed to make it easier to meet the test. With your permission, Mr. Chairman, we will be pleased to submit our specific recommendations to the Subcommittee following these hearings.

In conclusion, let me thank the Subcommittee for this opportunity to appear before you and to again say that we applaud Senator Dole and the Subcommittee for their interest in this important area of the tax law.

Senator DOLE. S. 3125 is a bill I have introduced. Treasury, I think, may support that proposal. I comment on S. 3125 in my general statement that has been made a part of the record.

[The summary of the Treasury Department positions and the Joint Committee on Taxation Estimates follow:]

SUMMARY OF TREASURY DEPARTMENT POSITIONS

1. S. 869 (Small issues exception to industrial development bond tax treatment).

The Treasury Department opposes the bill. S. 869 would entail a significant revenue loss. It would also permit industry to compete directly with state and local governments in marketing tax-exempt bonds. Thus, it would increase local borrowing costs and property taxes. Tax-exempt financing should be available only for state and local governments, and not for industry, which has access to other sources of funds.

2. S. 1674 (Employer recordkeeping and reporting duties as to employee tips).

The Treasury Department opposes the bill. Failure to report income from tips is a chronic and persistent compliance problem. This large continued tax avoidance diminishes public respect for the tax system, could jeopardize our voluntary system of compliance and is patently unfair to persons who must, as a result, bear a larger share of the tax burden. The substantial revenue loss attributable to the failure to report charge account tips could be stopped by a system of information reporting that would not impose significant administrative burdens on employers or employees. S. 1674 will present an open invitation for tip recipients to underreport tip income.

3. S. 2128 (Credit for the elderly).

The Treasury Department opposes the bill. The credit for the elderly is intended to give relief to low- and middle-income taxpayers. S. 2128 would make the credit available to high income taxpayers. It would also result in a substantial revenue loss. The Treasury Department particularly opposes indexing the credit for inflation. Indexing requires careful study. It would be a serious mistake to index the tax law piecemeal, without taking the time for adequate study.

4. S. 2393 (Treatment of certain liabilities on incorporation of a trade or business).

The Treasury supports the bill. However, some technical changes are necessary.

5. S. 2462 (Limited individual retirement deduction for plan participants).

The Treasury Department opposes the bill. Treasury is not opposed to the objective of S. 2462. It has supported a similar proposal (S. 3140). which is limited to employer contributions to simplified defined contribution plans. However, S. 2462 extends to all plans, including defined benefit plans. It would therefore cause unwarranted administrative and reporting burdens.

6. S. 3288 (Deduction for certain employee retirement savings contributions).

As Treasury indicated in previous testimony on a similar bill (S. 3140), there may be some merit in the principle of the bill to the extent it allows deductions for employee contributions where actual participation in the plan is nondiscriminatory. However, the Treasury believes the subject matter of S. 3288 should be considered only (1) in connection with the related problem of salary reduction arrangements, and (2) after taking into account the significant revenue loss involved with full implementation of the principle of the bill. The Treasury opposes the provisions of the bill relating to the contributions to individual retirement accounts. These provisions could result in discrimination against lower-paid employees.

7. S. 2628 (Disability income exclusion for married taxpayers).

The Treasury Department opposes this bill. The bill proposes an isolated change in the current basic concept of the tax law that generally treats a married couple as a single economic unit. The most familiar example of this idea is the different rate schedules applied to married couples compared to two single persons. There are many other provisions of the Code that make similar distinctions. Some of them are based on the idea that a married couple is likely to share an expense so that the amount is equivalent to the expense of one single person (such as the moving expense deduction). The Administration believes this issue must be studied as a whole.

8. S. 2825 (Public charity status of certain long-term care organizations).

The Treasury Department opposes the bill. Treasury believes that providing the same tax treatment for long-term care organizations as for the colleges, churches, and other organizations listed in section 170(b)(1)(A) is not justified, because long-term care organizations are less likely to have a broad base of public support. Treasury also notes that any long-term care organizations that do have a broad base of support are already exempted from private foundation status by Code section 509(a)(2).

9. S. 3007 (Prohibition of certain employment status reclassification by IRS).

The Treasury Department opposes the bill. It would interfere with the orderly administration of the tax laws.

10. S. 3037 (Employment tax status of certain real estate agents).

The Treasury Department opposes the bill. However, Treasury agrees that Revenue Rulings 76-136 and 76-137 should not be applied retroactively. Accordingly, a new revenue ruling will be published to revoke Revenue Rulings 76-136 and 76-137. The new ruling will reinstate the rules contained in Treasury Mimeograph 6566 with respect to the employment status of real estate salespeople for all periods prior to January 1, 1979.

11. S. 3080 (FUTA coverage of certain fishing boat services).

The Treasury Department defers to the views of the Labor Department.

12. S. 3125 (Involuntary conversion of special use valuation property).

The Treasury Department would support the bill if it were modified to (1) extend the recapture period of 15 years applicable to the qualified replacement by the period of any discretionary extensions of time to reinvest granted under section 1033(a)(2)(B)(ii); and (2) limit the increase in basis for additional estate tax to the amount attributable to the post-1976 appreciation.

13. S. 3301 (Basis of player contracts acquired with sports franchise).

The Treasury Department opposes S. 3301.

JOINT COMMITTEE ON TAXATION ESTIMATED REVENUE EFFECTS OF TAX BILLS

1. *S. 869 (Small issues exception to industrial development bond tax treatment).*—It is estimated that adoption of this bill would reduce budget receipts by $8 million in fiscal year 1979, $40 million in fiscal year 1980, and $136 million in fiscal year 1983.

2. *S. 1674 (Employer recordkeeping and reporting duties regarding employee tips).*—It is estimated that adoption of this bill would reduce budget receipts by less than $5 million annually.

3. *S. 2128 (Credit for the elderly).*—It is estimated that adoption of this bill would reduce budget receipts by $382 million in fiscal year 1979, $782 million in fiscal 1980, and $906 million in fiscal year 1983.

4. *S. 2393 (Treatment of certain liabilities on incorporation of a trade or business).*—It is estimated that adoption of this bill would reduce budget receipts by less than $5 million annually.

5. *S. 2462 (Limited individual retirement deduction for plan participants).*—It is estimated that adoption of this bill would reduce budget receipts by $74 million in fiscal year 1979, $119 million in fiscal year 1980, and $145 million in fiscal year 1983.

6. *S. 3288 (Deduction for certain employee retirement savings contributions).*—It is estimated that adoption of this bill would reduce budget receipts by $544 million in fiscal year 1979, $892 million in fiscal year 1980, and $952 million in fiscal year 1983.

7. *S. 2628 (Disability income exclusion for married taxpayers).*—It is estimated that adoption of this bill would reduce budget receipts by $17 million in fiscal year 1979, $10 million in fiscal year 1980, and $10 million in fiscal year 1983.

8. *S. 2825 (Public charity status of certain long-term care organizations).*—It is estimated that adoption of this bill would reduce budget receipts by less than $10 million in fiscal year 1979, and by less than $1 million annually thereafter.

9. *S. 3007 (Prohibition of certain employment tax status reclassifications by the Internal Revenue Service).*—To the extent that audit positions taken, and regulations and rulings issued, after December 31, 1975, would result in changes in the classification of workers from independent contractors to employees, there would be increases in Federal employment tax (FICA and FUTA) receipts. The number of workers who might be so reclassified is uncertain. The bill would prevent the IRS from applying any changed position or any newly stated position which is inconsistent with a general audit position in effect prior to January 1, 1976 or which is inconsistent with a regulation or ruling in effect on December 31, 1975, in determining whether an individual is an employee for purposes of FICA taxes, FUTA taxes, and Federal income tax withholding.

10. *S. 3037 (Employment tax status of certain real estate agents).*—To the extent that Revenue Rulings 76-136 and 76-137, and regulations, decisions, or rulings issued on or after December 1, 1975, would result in changes in the classification of real estate agents from independent contractors to employees, there would be increases in Federal employment tax (FICA and FUTA) receipts. The number of agents who might be so reclassified is uncertain. The bill would require the employment tax status of real estate agents to be determined according to the rules in effect prior to the issuance of the two 1976 rulings, and without regard to any regulation, ruling, or decision issued on or after December 1, 1975, which reaches a result which is the same as or similar to the result of the two 1976 rulings.

11. *S. 3080 (Unemployment tax status of certain fishing boat services).*—It is estimated that adoption of this bill would reduce budget receipts, under the Federal Unemployment Tax Act, by less than $1 million annually.

12. *S. 3125 (Involuntary conversion of special use valuation property).*—It is estimated that adoption of this bill would reduce budget receipts by less than $5 million annually.

13. *S. 3301 (Basis of player contracts acquired with sports franchise).*—It is estimated that adoption of this bill would reduce budget receipts by $3 million over a period of 5 years.

Senator DOLE. The final two witnesses even though they are separate bills might both come forward: Mr. Tolley and Mr. Schulman.

We might also ask the Treasury to submit their views on S. 2393 in writing.

Mr. SAMUELS. We will submit our written testimony on each of the bills, Senator.

Senator DOLE. Mr. Tolley, executive director of the Shellfish Institute of North America.

STATEMENT OF E. A. TOLLEY, EXECUTIVE DIRECTOR, SHELLFISH INSTITUTE OF NORTH AMERICA

Mr. TOLLEY. Mr. Chairman and members of the subcommittee, my name is Everett A. Tolley and I am executive director of the Shellfish Institute of North America. Because I would like to be brief, I wish to state at this point that our association, a national one, is in favor of adoption of the bill S. 3080 to amend the Internal Revenue Code of 1954 to exclude certain services performed on fishing boats from coverage for purposes of unemployment compensation.

Clearly the law needs to be adjusted to exempt the self-employed fishermen from the unemployment taxes.

Our association strongly urges the Congress to take favorable action on this important bill.

I would like to express the appreciation of the Shellfish Institute of North America—which was chartered, incidentally, in 1908, for giving us an opportunity to testify on this bill.

Thank you.

Senator DOLE. I appreciate that very much and your entire statement will be made a part of the record.

[The prepared statement of Mr. Tolley follows:]

STATEMENT BY EVERETT A. TOLLEY, EXECUTIVE DIRECTOR, SHELFISH INSTITUTE OF NORTH AMERICA

Mr. Chairman and members of the subcommittee; My name is Everett A. Tolley. I am executive director of the Shellfish Institute of North America.

Our national trade association, the Shellfish Institute of North America, represents producers, processors, distributors and suppliers of oysters, clams, blue crabs, and various segments of the shellfish industry.

Our Association is in favor of adoption of S. 3080, to amend the Internal Revenue Code of 1954 to exclude certain service performed on fishing boats from coverage for purposes of unemployment compensation.

Under the 1976 Federal Tax Reform Act, commercial fishermen who work aboard vessels having fewer than 10 in the crew and who receive a share of the trip in payment for their work are considered selfemployed. As a result, the act states that Federal income tax and social security taxes need not be withheld from the crew members share by the boat owner since he is not an employer; however, the boat owners must keep records and must report the total of the shares for each crew member at the end of the year; and, of course, the crew members are liable for their income tax and social security as are all other self-employed persons.

The Federal Government has declared, in essence, that the crew member's share is not wages from which the usual payroll deductions can be taken. The filing of quarterly reports is a nuisance and costly to say the least; in the case of the normal shrimp boat operation, there are only three in the crew and the revenue produced is small compared to the expense of records, reports, and remittance.

Clearly the law needs to be adjusted to exempt self-employed fishermen from the unemployment taxes. Our association strongly urges the Congress to take favorable action on this important bill.

I would like to express appreciation of the Shellfish Institute of North America for giving us an opportunity to testify on this bill.

Thank you.

Senator DOLE. I understand on this measure the Treasury defers to the views of the Labor Department. Is that correct?

Mr. SAMUELS. That is correct, Senator.

Senator DOLE. So you have no comments?

Mr. SAMUELS. No, this involves solely the unemployment compensation, and we defer to Labor.

Senator DOLE. I do not know if there is anybody here from the Labor Department. We will request their views and they will be included in the record.

Thank you very much.

We are in the last quarter here. The last witness is Mr. Schulman representing the New England Patriots. There is about a minute to go, so we will have to go for a field goal.

Mr. SCHULMAN. We will try real hard. We will use Mr. Grogan, of Kansas, to do it.

STATEMENT OF ROBERT A. SCHULMAN, NEW ENGLAND PATRIOTS FOOTBALL CLUB, INC.

Mr. SCHULMAN. My name is Robert A. Schulman. I am a partner in Williams and Connolly and I am up here appearing here on behalf of Bill Sullivan, the founder and president of the New England Patriots Football Club, Inc. and the New England Patriots.

The legislation we support is S. 3301 which provides an exception to section 212(a) of the Tax Reform Act of 1976, now section 1056 of the code.

Bill Sullivan founded the Patriots after two other teams failed in Boston and has lived and died with them and kept them alive under very adverse circumstances. As of 1973, there were 100,000 voting shares outstanding, of which he owned 24 percent, and there were approximately 140,000 nonvoting shares outstanding.

A dispute arose between Bill and two other separate groups of stockholders which was bitter and acrimonious and which was finally settled in 1975, after 3 years of desperate and difficult negotiations, under which Bill undertook to buy out the entire remainder of the voting stock.

In order to do this, he had to go to a bank and borrow $5.3 million-plus on his own personal loan, and the bank made two very, very stringent requirements: One, that all the securities of the club, the voting stock and the nonvoting stock be pledged; and second, that all of the assets of the club be pledged—that is, its player contracts, its television revenues and every other asset of any value.

In order to do this and in order to obtain this loan, Bill had to restructure the corporation. On November 7, 1975, long before the enactment of the Tax Reform Act and long before any consideration to amending the tax law as to depreciation of player contracts, Bill signed the papers, borrowed the money, and purchased all of the voting stock for upward of $5.3 million.

Thereafter, over a 2-year period by reason of litigation which went to the first circuit court of appeals, and in which he prevailed, a new company was formed to which Bill contributed all the voting stock.

The old company was dissolved and the nonvoting stockholders were paid out at $15 a share, which was a capital gain of $10 to many of them. This was no freezing out of anybody.

All of this was done under the bank's understanding and the careful representations, independently arrived at by both the bank's attorneys and by the company's attorneys, that the depreciation would be sufficient to allow them to service the debt.

This was done, as I said a few moments ago, long before any consideration was given to amending the law.

As a result of the amendment, Bill Sullivan was caught in midstream after having made the commitment and borrowed. He has his whole life, his whole net worth in this ballclub. He has pledged everything he owns to do it, and all we are asking here is fairness.

We have heard that one of the advantages of being the last witness is that you hear a lot of testimony previously, and we have heard a good deal this morning in other respects about the Treasury not wanting to apply new rules retroactively and about the tax system's being fair, and that is all we are asking.

Bill is the only one we can think of who was caught in the middle of a commitment already made and a loan already incurred without any knowledge of any change in law, and we feel that if the Internal Revenue Service were to do what it has done in the past, what it has characteristically done, and if the Congress is going to do what it has characteristically done, if what I did when I was down in the Internal Revenue Service is going to remain, which is "do not be unfair to people and do not apply new rules retroactively," then this relief is eminently proper.

I have to be candid, as I was before this committee in October of 1977 when Senator Packwood conducted the hearing and expressed great sympathy with this problem, in pointing out that this is special legislation. We know of no one else who was caught in the middle as Mr. Sullivan was, having made the commitment, having borrowed the money, having bought the stock in November of 1975, long before the law was changed or any consideration was given to changing the law.

The tax cost to the revenue, as best we can figure it, is about $600,000 a year for a period of 5 years, and this tax cost is not a full tax cost because it is recoupable should the team ever be sold, which Bill dearly hopes very candidly never to have to do, the Government will recapture this tax loss by way of recapture of depreciation.

I realize it is late. I realize you have a television appointment, and I thank you for the courtesy and consideration.

This bill is supported by many of the Senators from New England, and by others besides. Senator Bayh introduced it and it is cosponsored by Senators Brooke, Pell, and Chaffe,

We will be glad to answer any questions.

Senator DOLE. Well, I might say first of all, if you have a written statement——

Mr. SCHULMAN. Yes, I do, sir, and I respectfully request that that be put into the record.

Senator DOLE. It might be helpful if you would introduce those who are with you for the record.

Mr. SCHULMAN. I beg your pardon.

This is Mr. Sullivan, the taxpayer in question; Mr. Charles Sullivan, his son; and Barry Weisman of our office who has worked on this matter with me.

Senator DOLE. This is my first contact—I know about the Patriots, but I did not know about the tax problem. I assume the Treasury is opposed to the bill.

Mr. SAMUELS. We do oppose the bill, Senator.

Senator DOLE. Do you want to file your opposing views?

Mr. SAMUELS. Well, we can file them. I think it is just a question of what the effective date should be.

Mr. SCHULMAN. The only effective date we are asking for, if I may respond, and the only reason we are asking for it, is because of a man who had made a commitment in reliance on then existing law and a bank which required that commitment on reliance on that existing law and he had gone through with the commitment and he had to complete the plan and dissolve the company and pledge the assets and pledge the stock, all of which was done, and after the commitment was made, after the $5.3 million was borrowed, and then later on, another $1.4 million borrowed, after that the law was changed, and all we are asking is that he be put in the same position as he would have been had the law not changed when he has acted in reliance, as any taxpayer is entitled to do, on existing law in dealing with his business transactions.

Senator DOLE. There is no dispute about those facts?

Mr. SCHULMAN. None whatsoever, to the best of my knowledge.

Mr. SAMUELS. Those are the facts. I think what happened, Senator, was that the President signed the tax reform act in October of 1976. Most of the effective dates, including the effectiveness of this provision, was December 31, 1975.

Mr. SCHULMAN. November 7, 1975, was when he borrowed and paid the $5.3 million and bought the stock.

Senator DOLE. Is this one of those where we changed the effective dates in conference?

Mr. SAMUELS. I do not know if that was changed in conference.

Senator DOLE. A lot of that was done to pick up revenue.

Mr. Sullivan, do you want to add anything?

Mr. SCHULMAN. I would like to add one other thing. Senator Packwood conducted a hearing here in October of 1977 and he expressed very clearly his sympathy for this thing and we outlined the story much the same as we have here, together with a statement filed by me.

Senator DOLE. I cannot judge the case.

Mr. SCHULMAN. May I quote just one sentence from Senator Packwood?

> Let me say that the Congress did not intend to prejudice a taxpayer midstream. We were looking at people who were rolling over franchises and depreciating player contracts. It was never intended to apply to long-term owners trying to build a club. You do not need to feel embarrassed or ashamed to plea for special legislation. Every now and then when the media brings up special interest legislation, the question should be what is meritorious.

That is the only point I am making. Senator Packwood made it better than I did.

Mr. SULLIVAN. Senator, I might just make this statement. Unlike Lamar Hunt who owns a team in your State. I did not inherit very much money when my dad died, but I did inherit, I think, a pretty good sense of values, and I do not think that the Congress of the United States should ever be asked to design legislation to benefit one individual. I also do not think it should be asked to design legislation to punish one individual, and I am the only person in America, as I understand it, that suffered by this rule.

I spent 17 years building this franchise through difficult times. Unlike many communities where the Federal Government or the city or the State built stadia, we did not have that happen in our place. We built a stadium in a little town called Foxboro more with our own money rather than anyone else's. No subsidy from the town, the county, the State or anybody.

I think it is very unfortunate that this rule, which I think was well-meant and well-intentioned, I guess is the best word, was designed because people were buying franchises, trying to use tax shelters in the World Football League, the American Basketball Association and all of these entities. We did not do that.

We have been in this thing since the beginning. We went to Boston University with 20,000 seats, Fenway Park with 39,000, Boston College with 26,000, Harvard with 39,000 and 1 year we could not get a place. We played our opening game in the glorified atmosphere of the American Legion Field in Birmingham, Ala.

We have had a real struggle, and I just do not believe that the Congress in its wisdom and the Treasury Department in its wisdom can say that one person can be asked to pay for the sins of those who did try to use the existing law, I think, unfairly, because we never have.

Senator DOLE. I appreciate very much the testimony. I am sympathetic. You want a little more than that.

Mr. SCHULMAN. We do indeed, and we thank you for your consideration.

[The prepared statement of Mr. Schulman follows:]

STATEMENT OF ROBERT A. SCHULMAN, ESQ., WASHINGTON, D.C., IN RE S. 3301—A BILL TO LIMIT THE RETROACTIVE APPLICATION OF SECTION 1056 OF THE INTERNAL REVENUE CODE OF 1954 (AS ADDED BY SECTION 212 OF THE TAX REFORM ACT OF 1976)

My name is Robert A. Schulman. I am an attorney practicing law in Washington, D.C. as a senior partner of Williams & Connolly. I am appearing as counsel to William H. Sullivan, Jr. and the New England Patriots Football Club, Inc. Mr. Sullivan, the founder and President of the Patriots, is here with me today.

I speak in favor of the adoption of S. 3301. The intended beneficiaries of S. 3301 are William H. Sullivan, Jr. and the New England Patriots Football Club, Inc. The purpose of the bill is to correct an inequity resulting from a major change in the tax rules affecting the allowance for depreciation of players' contracts owned by sports enterprises. This change is the result of the enactment of section 212 of the Tax Reform Act of 1976, which added section 1056 to the Internal Revenue Code. S. 3301 does not change the operative provisions of section 1056 of the Internal Revenue Code but, instead, provides a limited exception to the application of section 1056 of the Code in a situation where, prior to the enactment of the Tax Reform Act, a taxpayer had entered into binding commitments based on then existing law.

As I stated, the specific statutory section with which we are concerned is section 1056 of the Internal Revenue Code. It provides that when player contracts are transferred in conjunction with a sale or exchange of a franchise to conduct a sports enterprise, the acquirer's basis in the player contracts is limited to the transferor's basis in such contracts plus the gain recognized by the transferor. Prior to the enactment of section 1056 of the Code, there was no statutory provision so limiting the basis of player contracts.

The pertinent facts here involved are:

As of 1973, the Patriots had outstanding 100,000 shares of voting common stock and 139,800 shares of non-voting common stock. In 1973, certain problems arose between Mr. Sullivan, who held about 24% of the voting shares, and two other groups of voting shareholders. After extended negotiations, these problems were resolved in 1975 by Mr. Sullivan committing himself to purchase the voting shares of the other two groups which together held the remaining voting shares and then to restructure the corporation through the formation of a legal entity as the successor to the Patriots.

Pursuant to that undertaking and on November 7, 1975, Mr. Sullivan borrowed in excess of 5.3 million dollars which he used to purchase from the other two groups all of their voting shares.

This buyout of the other voting shares by Mr. Sullivan was accomplished (a) on his representation to the bank that when the rest of the plan was carried out, in addition to all of the ownership interest of the new entity, the principal assets of the new entity as well—that is, the NFL franchise, player contracts, ticket sales and television revenues—would be pledged as security for the loan to Mr. Sullivan personally, and (b) on the clear understanding, both by the bank and by Mr. Sullivan, each of whom was independently so advised, that the new entity would be entitled to a basis for player contracts in accordance with then current provisions of the Internal Revenue Code.

Thereafter and pursuant to a proxy statement dated November 5, 1976, in all essential respects identical to the proposed proxy statement filed September 9, 1976, the restructuring of the Patriots was accomplished through a state law merger into New Patriots Football Club, Inc., a newly formed Massachusetts corporation. This state law merger constituted a taxable event both to the holders of the voting and the non-voting stock of the Patriots.

The effect of the statutory provision hereinvolved on those facts is that solely because of the addition of section 1056 of the Code and in midstream of a plan the first of the two major steps of which was consummated in 1975 after almost three years of difficult negotiations, Mr. Sullivan will be unable to service and amortize the loan of 5.3 million dollars already made to him personally and the new entity will be unable to service and amortize the additional loan of approximately 1.4 million dollars, borrowed by it to assist in paying for the non-voting stock of the Patriots. Therefore, because of the legislative changes made in 1976, and after Mr. Sullivan had made commitments based on the then law, Mr. Sullivan now faces the serious risk of being unable to retain the ownership interest of the football team which, since its founding in 1960, he has continuously fought to save and preserve, and which constitutes almost his entire net worth.

The proposed bill, which we believe affects only Mr. Sullivan and the New England Patriots Football Club, Inc., in these limited circumstances, would continue for this one transaction only, the basis for player contracts which existed under the law prevailing at the time the commitment was made for the first loan of 5.3 million dollars to Mr. Sullivan personally—and at the time Mr. Sullivan purchased the other voting shares—each of which occurred in 1975, long prior to the enactment in 1976 of section 1056 of the Code.

We previously have appeared before this Subcommittee in connection with an attempt to have H.R. 8489, which would provide similar relief to the Patriots and Mr. Sullivan, appended to the Technical Corrections Act. The full Finance Committee deferred action on that measure not because there was a feeling that the measure lacked merit but because of the view that the Technical Corrections Act may not have been the appropriate vehicle for such relief. The bill, which has taken several forms, and which we bring before you today has never been rejected by either the House or the Senate or any Committee or Subcommittee thereof on its merits. In fact, in the waning moments of the 94th Congress, a bill on behalf of Mr. Sullivan and the Patriots passed the Senate as a floor amendment and failed unanimous consent in the House by merely a single objection.

Nor would this bill have a meaningful impact on the revenue. The tax loss would be only approximately $600,000 a year for five years, and the amounts claimed as player contract amortization would be subject to recapture upon any future sale of the Club.

We fully acknowledge that we are pleading for special legislation. But we believe that when only one person, one transaction, is caught mid-stream by a change in law, special relief, in the form of limiting the retroactive application of the change in law, is not inappropriate. As you know, the Internal Revenue Code, has for many many years provided for relief from the retroactive application of rulings and regulations. And that in essence is all that we seek here today.

We sincerely thank you for your consideration of this matter.

Senator DOLE. Thank you very much. Treasury can file its views. The hearing record will be open for 10 days.

Mr. SAMUELS. Can we have longer than that to submit our statement, maybe 3 weeks? [1]

Senator DOLE. Three weeks. That is no problem. We want to adjourn in October.

Mr. SAMUELS. Thank you.

[Thereupon, at 1:15 p.m. the hearing in the above-entitled matter was adjourned.]

[By direction of the chairman the following communications were made a part of the record:]

STATEMENT BY SENATOR DANIEL K. INOUYE

Mr. Chairman, I appreciate this opportunity to present testimony to your distinguished subcommittee relating to my bill, S. 2128.

The elderly—those persons 65 years of age and older—make up a significant and rapidly growing part of our population. The Senate Special Committee on Aging published figures this year showing that this trend towards a graying America can be expected to continue. In 1776 some 50,000 of this infant nation's 2.5 million citizens were elderly, or one out of every 25 persons. This grew by 1900 to 3 million, or one out of every 25 Americans. By mid-1977, we saw the population of senior citizens rise to 23.5 million, or one of every 9 persons. This segment of the population is expanding three times faster than the remainder of the nation.

The sad, but undeniable, fact we must face is that we have failed to adequately care for these elderly citizens who have made major contributions to our nation's defense and economy. Some 3.3 million of them live in poverty, many falling into that state only after reaching the age of 65 because they suffered from a drastic cut in income, usually one-half to two-thirds.

The tax credit for the elderly, enacted as a part of the Tax Reform Act of 1976, grew out of and replaced something called the retirement income credit. The underlying purposes of the tax credit for the elderly and its predecessor was to establish a rough parity between social security recipients, who receive their benefits free of tax, and persons who paid into various public retirement systems rather than social security. The change was occasioned by a number of factors, including testimony indicating that as many as one-half of all elderly individuals eligible to use the retirement income credit did not claim it on their returns because it was so complex.

The adoption of the tax credit for the elderly was a big step in the right direction, but I believe the time has come to adjust it so that it better meets the needs of our elderly population.

My bill makes three changes in the tax credit for the elderly:

(1) It increases the maximum tax credit available;

(2) It removes the "phase out" provision in current law which reduces and eventually extinguishes the credit as adjusted gross income rises above certain levels; and

(3) Attempts to build in a cost-of-living provision so the credit will keep pace with inflation.

In testimony both before the subcommittee and before the Senate Special Committee on Aging, the Administration has expressed opposition to this bill. The major objection, as I understand it, is not so much the revenue loss involved, but its distributional aspects and the indexing provision. The Administration originally put the cost of the bill at some $963 million. I felt this figure was almost certainly too high and was pleased to see that this figure was recently

[1] At presstime Feb. 14, 1979 the information requested of the Treasury Department had not been received by the committee.

cut by nearly 25 percent to $727 million. The distributional aspects of the measure are shown in the following table:

—	Returns	Tax relief (millions)
1978 income levels:		
0 to $5,000	12,000	$0.2
$5,000 to $10,000	515,000	49.6
$10,000 to $15,000	668,000	161.7
$15,000 to $20,000	471,000	154.4
$20,000 to $30,000	453,000	161.6
$30,000 to $50,000	273,000	104.8
$50,000 to $100,000	142,000	64.8
$100,000 to $200,000	43,000	21.5
$200,000 plus	17,000	8.2
Total	2,596,000	727.0

This measure and the identical House bill have wide support. The House measure, H.R. 8818, has 138 cosponsors, including 11 members of the House Ways and Means Committee and Chairman Pepper of the House Aging Committee. My bill has 13 cosponsors, including Senators Domenici and Chiles of the Special Committee on Aging and Senators Hathaway, Dole and Haskell of the Finance Committee.

I would hope that this subcommittee would report the bill in its present form. I recognize, however, that the time remaining in the 95th Congress is growing very short and the legislative calendar is full. In the interest of further increasing the substantial support this bill already enjoys, I want to take this opportunity to mention an alternative which would be acceptable to me and which I could reasonably suggest to my colleagues who have already provided their support.

Specifically, since the Administration's prime objection seems to relate to the fact that some high-bracket taxpayers might benefit from the bill in its present form, I would suggest that "phase out" provisions be retained, but that they be raised from $7,500 to $15.000 for single aged persons and from $10,000 to $17,500 for elderly couples (and $5,000 to $8,750 for elderly married individuals filing separately). I am advised that by making this change and deleting the indexing provision, the estimated revenue loss would be approximately $525 million, assuming a 1979 effective date.

If the subcommittee finds this alternative suggestion more attractive than the bill as originally introduced, I would be pleased to do everything I can to generate support for it. I would only ask that the revised bill be handled in such a way that the supporters of the original proposal are given full credit for their early recognition of the needs this bill is designed to meet and their work and dedication in support of it.

Statement of the Honorable Frank Church

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to submit testimony on the need to update the tax credit for the elderly.

This provision is designed to provide relief for moderate-income retirees with little or no Social Security, such as retired teachers, policemen, firemen, or other government pensioners. Social Security benefits, as you know, are exempt from Federal income tax.

Under present law, taxpayers 65 years or older may claim a 15-percent credit on up to $2,500 for individuals and $3,750 for elderly couples. This produces a tax savings up to $375.00 ($2 500 × 15%=$375.00) for an individual and $562.50 ($3.750 × 15%=$562.50) for a couple.

The maximum amounts for computing the credit, however, are reduced (1) dollar-for-dollar by Social Security and other tax-exempt Federal benefits and (2) by $1 for each $2 of adjusted gross income above $7,500 for aged individuals and $10,000 for elderly couples. Thus, the credit is phased out completely for older individuals with income of $12,500 or more and aged couples with $17,500 or more.

The tax credit for the elderly has helped to ease the tax burden for older Americans. However, it still does not provide comparable relief for persons with limited or no Social Security. The maximum amounts for computing the credit fall far short of the maximum Social Security benefits—now $5,876.40 a year for individuals and $8,814.60 for qualifying couples.

Mr. Chairman, I realize that it may not be feasible at this time to place government pensioners on a par with Social Security beneficiaries in terms of tax relief because of cost considerations. But, other constructive actions can be taken to modernize the tax credit for the elderly.

This is why I have joined Senator Inouye in advancing legislation to raise the maximum amounts for computing the credit from $2,500 to $3,000 for single persons and from $3,750 to $4,500 for couples. This change alone could provide an additional $75 in tax relief for individuals and $112.50 for couples.

In addition, our proposal would raise the adjusted gross income phase-out provisions from $7,500 to $15,000 for individuals and from $10,000 to $17,500 for couples.

More than 1.4 million returns with an aged taxpayer would be benefitted from these two proposed changes. Equally important, our legislation would provide tax savings for persons with the greatest need—lower and moderate-income individuals. In fact, our proposal would target 94 percent of the relief to aged taxpayers with annual incomes under $20,000 and 65 percent to elderly taxpayers with annual incomes under $15,000.

Rising prices have cut deeply into the pocketbooks of older Americans. Tax relief in the form of updating the credit for the elderly and other measures can help to provide welcome relief from the inflationary spiral which now affects so many senior citizens.

For these reasons, I urge the approval of these changes to the tax credit for the elderly.

STATEMENT OF SENATOR MIKE GRAVEL

Mr. Chairman, I wish to indicate my support of S. 3037 sponsored by Senators DeConcini and Haskell and of S. 3007 sponsored by Senator Dole. These measures would negate the effects of the IRS ruling which reclassified real estate salespersons as employees for taxation purposes, allowing these individuals to regain their independent contractor status.

The changes in taxation of real estate agents reversed twenty-five years of established guidelines. The implementation of the changeover has caused some grossly unjust practices which are creating havoc in the real estate business and threatening some brokers with financial ruin. Under the independent contractor status, the real estate agents were themselves responsible for payment of income and social security taxes. The reclassification of sales personnel as employees means that the real estate brokers are responsible for deducting income tax and social security taxes from the paychecks of these persons. Back-tax claims by the IRS threaten brokers with large liabilities. In this type of situation, taxes are often collected twice on the same income, as brokers are liable for taxes which the employee may have paid himself under the independent contractor status but for which there is no record available to the broker. Real estate firms across the country have been forced to seek legal aid and are faced with the expense of filing law suits in an attempt to reverse the charges which were in the first place unjustified.

The revenue ruling which changed the taxation status of real estate salespersons was issued a few months before Congress ordered a study to be made as part of the 1976 Tax Reform Act on the problematic classification of persons as employees or as independent contractors. The study was ordered in an attempt to arrive at a comprehensive general policy. The Congress directed the IRS to refrain from making changes in taxation practices relating to the area under study until recommendations based on the findings of the report could be instituted. Since the revenue ruling affecting the real estate business was issued a few months prior to the Congressional directive putting a hold on changes in this area, the IRS maintains that the directive should not apply to these rulings.

Mr. Chairman, I contend that even though the revenue ruling in question was issued before the Congressional directive, the reasons which prompted Congress to issue the directive apply to this situation. Without the report which would establish principles upon which to base policies of classification and taxation, it is necessary to rely on precedent. The revenue ruling changed guidelines which had been in effect for a quarter of a century. It is imperative that we take measures to reinstitute the previous classification of real estate agents. The unfair practices arising from such a reversal in trends is indicative of the need to avert further injustices. The sudden switch in the course of taxation practices left some businessmen sitting high and dry.

STATEMENT OF SENATOR DALE BUMPERS

Mr. Chairman, all of us from time to time receive letters from constituents calling our attention to various inequities and omissions in the Internal Revenue Code—precisely the kind of complaint that led President Carter, during his campaign for election to refer to the code as "a disgrace to the human race." I can associate myself with this characterization without reservation, and I would like to offer for the edification of my colleagues a particularly glaring example that has been called to my attention by one of my constituents, Mr. Joe Redding of North Little Rock, Arkansas. There are many ironies in this case, not the least of which is that Mr. Redding, before he was compelled to retire on account of permanent and total disability, served the Internal Revenue Service as an agent for 25 years.

In 1954, when the Internal Revenue Code was enacted, Congress wisely saw fit, in section 105, to recognize the special situation in which ill, injured, or disabled citizens find themselves. Under this provision, which was substantially unchanged for 22 years, an employee could exclude from income up to $100 a week received under wage-continuation plans when he was absent from work on account of injury, sickness, or disability. Persons in this category obviously have special problems and special demands on their resources. The sick-pay exclusion as section 105 came to be called, is a recognition of these problems much like the deduction for medical and hospital expenses.

The Congress and President Ford then enacted the so-called Tax Reform Act of 1976. I say "so-called" because the title of this Act is a complete misnomer. As a matter of fact, I joined 21 other Senators in voting to strike the word "Reform" from the title of the bill, but unhappily the motion failed. In any case, section 505 of this Act, which is now Public Law 94–455, repealed the sick-pay exclusion and provided in its place an exclusion of up to $5,200 a year for retirees under age 65 who are permanently and totally disabled. This exclusion is to be phased out dollar for dollar for adjusted gross income in excess of $15,000, the theory being, I suppose, that people with income in that range do not need the exclusion so much. In view of the tremendous costs that illness and disability can bring, I question the validity of this premise, but the portion of the Act that has attracted my attention is even more unfair. New section 105(d)(4), as added by the 1976 Act, requires married taxpayers to file a joint return if they are to get any benefit from the exclusion. The purpose of this requirement is unhappily clear. It is simply to attribute to a taxpayer whatever income his or her spouse may have for purposes of computing the $15,000 phaseout level. A taxpayer will lose the benefit of the exclusion, in other words, just as surely if his spouse has income as if he has income himself. No showing is required that the taxpayer actually benefits from his spouse's income, nor is account taken of the fact that the spouse also may be disabled or ill, with high medical expenses. Furthermore, Mr. Chairman, the law goes on to say that a married taxpayer can get the benefit of the exclusion, even if he does not file a joint return, if he and his spouse live apart at all times during the taxable year.

I cannot imagine a clearer financial incentive for the separation of families. The provision is especially cruel because the incentive, by definition, applies only to taxpayers who are permanently and totally disabled.

In other words, Mr. Chairman, a permanently and totally disabled citizen can exclude his disability payments from gross income regardless of what his spouse earns if he gets a divorce or separates himself from her completely. But if he continues to live with his family, and if his spouse works and earns a living, he loses the benefit of this important exclusion. No doubt there are many quirks in the Internal Revenue Code and many inequities, but I defy my colleagues to come up with one so striking as this. Those who wrote the 1976 Act probably thought that by adding section 105(d)(4) they were protecting the public revenues, and there is no doubt that revenue probably will be increased to some extent, because this provision is in the statute. I cannot believe, however, that the minuscule increase to the Treasury is worth the hardship and suffering, mental and economic, that this kind of law can provoke. I have therefore, Mr. Chairman, introduced a bill to repeal section 105(d)(4) of the Internal Revenue Code. The general rule that sick-pay exclusion phases out at $15,000 of adjusted gross income will remain untouched. The only effect of my bill will be to restore the taxpayers their customary election whether to file a joint or separate return, and the bill will also, of course, remove one of those incentives, with which the Internal Revenue Code is strangely full, for the splitting up of families.

Mr. Chairman, I ask that this statement be made a part of the record of the hearings conducted by your Subcommittee on the bill S. 2628. In addition, I would like to point out that an amendment to the bill to specify an effective date would probably be in order. The effect of the bill should be retroactive to enactment of the Tax Reform Act of 1976, so that complete relief to affected taxpayers can be afforded.

The text of my bill as originally introduced is as follows:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, that paragraphs (4) and (6) of Subsection (d) of Section 105 of the Internal Revenue Code of 1954, as amended by Subsection (a) of Section 505 of the Tax Reform Act of 1976, Public Law 94-455, approved October 4, 1976, are hereby repealed.

SEC. 2. Paragraph (5) and (7) of Subsection (d) of Section 105 of the Internal Revenue Code of 1954, as amended by Subsection (a) of Section 505 of the Tax Reform Act of 1976, Public Law 94-455, approved October 4, 1976, are hereby renumbered (4) and (5).

AMERICAN BANKERS ASSOCIATION,
Washington, D.C., July 31, 1978.

Re: Comments on S. 2462 and S. 3125, Hearings on Miscellaneous Tax Bills.

Hon. HARRY F. BYRD, Jr.
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In the *Congressional Record* of July 17, 1978 you announced hearings on various miscellaneous tax bills. We would like to take this opportunity to have our comments on two of the bills included as part of the record of your hearings.

The first bill we would like to comment on is S. 2462. This legislation would allow an active participant in a qualified retirement plan to establish an individual retirement account. The worker could contribute to the "limited IRA" the difference between the maximum IRA deduction allowable, currently the lesser of 15 percent of compensation or $1,500, and the amount contributed on his behalf to the qualified pension plan.

The American Bankers Association supports the idea of the "LIRA" embodied in S. 2462. We believe that employees should be encouraged to plan adequately for their retirement years and active participants should be able to receive deductions for money put in a limited IRA. We are flexible on the approach taken to achieve what we see as the primary purpose of S. 2462—to allow active participants as much coverage as individuals who are not active participants can have by establishing an IRA. We recognize that there are problems in designing a "limited IRA" program which is both equitable in its coverage and workable in its administration. We would like to offer some suggestions which should be considered in structuring a viable LIRA program.

While we support the LIRA concept, we are very concerned that the program adopted not put new burdens on existing qualified plan administration. The proposed LIRA would require plan administrators to undertake additional calculations and notifications. We do not wish to unnecessarily complicate the LIRA concept found in S. 2462, but we believe that the LIRA program may have to be structured to distinguish between participation in a defined contribution plan and a defined benefit plan to balance the need for equitable coverage at a reasonable administrative cost. The following approach might be considered by the Subcommittee:

1. All employees covered only by a defined contribution plan would be eligible to make an annual off-set contribution to an IRA equal to the difference between the defined contribution for them under their employer's plan and 15 percent of their pay, with a dollar maximum of both plans of $1,500. This calculation should not be too difficult to make but there is a problem of how quickly this information could be computed and distributed to the employee. In order not to complicate the IRA program, perhaps the deductible contribution by the employee would have to be made for the year following the year for which the employer's contribution is calculated.

2. All employees covered by a defined benefit plan would be eligible to make an annual contribution to an IRA up to a limit of perhaps 7 or 8 percent of pay with a maximum $700 or $800. Some presumption of the employer's contribution is necessary because of the complexities of the actuarial calculations of a defined benefit plan such as factoring in the age of the employee, years to retirement, years of participation, etc. (If the Congress would want to exclude highly compensated employees from this program, there could be a provision to reduce the $800 maximum by a certain dollar figure for each $1,000 compensation above some level of income.)

3. All employees covered by both a defined contribution and defined benefit plan perhaps should not be eligible for any special deductible contribution. This point should be further analyzed but a banker who discussed this matter with some of his customers and actuaries found that companies with a combination of two or more plans many times have contributions coming close to or exceeding the 15 percent limit.

We would also like to express our support for the technical changes in the estate tax law in S. 3125. The Tax Reform Act of 1976 provided that certain property used in farming or a closely held business could be valued for estate tax purposes according to its current use rather than its highest and best use. The special use valuation rule of § 2032A aids those estates which have a significant portion of their value in these non-liquid assets. The purpose of this rule is to encourage the preservation of farms and closely held businesses by not forcing them to be sold to pay higher estate taxes. However, to carry out the policy behind § 2032A, there is a recapture of the tax benefits if the heirs dispose of the property or change its use within fifteen years of the decendent's death. S. 3125 is designed to lessen the harsh tax results when an involuntary conversion takes place within the fifteen year recapture period. Since the devisee has not voluntarily changed the use of the property, we feel that as a matter of equity, the devisee should be able to mitigate the harsh tax impact by being allowed to invest in like property of equal value and use to replace the involuntarily converted property. This treatment for purposes of estate taxes would parallel existing income tax treatment given to involuntarily converted property. We also support the provision in S. 3125 which would provide for an upward basis adjustment for the full amount of this recapture tax when there is no replacement of special valuation real property.

We thank you for the opportunity to comment on these pieces of legislation.

Sincerely yours,

KATHLEEN L. O'FLAHERTY,
Assistant Federal Legislative Counsel.

THOMPSON BROS. PULP WOOD AND LUMBER CO., INC.,
Ticonderoga, N.Y., June 31, 1978.

Mr. MICHAEL STEIN,
Staff Director, Committee on Finance,
Dirksen Senate Office Building, Washington, D.C.

DEAR SIR: We are a pulpwood dealer in Ticonderoga, New York. We feel compelled to write you to express our concern over Senate Bill 3007 which deals with employer-employee and independent contractor relationships for purposes of Internal Revenue Service classification.

We exercise no form of control over the people who bring pulpwood to the pulp mills under our contract. We do not oversee their logging practices or methods, or make any determination as to who they hire or fire. They make their own contracts with landowners and get required permits from the New York State Department of Conservation when necessary. They run their jobs with their own equipment, handle their own payroll, and we make no decisions in any phase of their operations.

We think these factors clearly indicate that our relationship with these loggers is that of an Independent Contractor, and not one of employer-employee.

For these reasons we are in full support of the American Pulpwood Association's position, and feel that the wording of House Bill (H.R. 13313) will provide us with fair and reasonable protection, that our business may continue without burdens placed on us which we feel are unfair, and might prove very detrimental.

Sincerely yours,

WILLIAM POLIHRONAKIS.

SUTHERLAND, ASBILL & BRENNAN,
Atlanta, Ga., July 31, 1978.

Re Statement on Behalf of Independent Gasoline Marketing Companies on S. 3037 and S. 3007.

Hon. HARRY F. BYRD, Jr.,
Chairman, Committee on Finance, Subcommittee on Taxation and Debt Management, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a statement which we are filing today on behalf of several small independent gasoline marketing companies on S. 3037 and S. 3007. Our firm is representing clients in several other industries concerned with this problem, and Jerome B. Libin of our Washington office presented testimony on behalf of several insurance companies. We thought this special presentation was appropriate on behalf of a number of small businesses which are especially burdened by this problem.

The businesses in question include both small gasoline marketing companies which supply gasoline to contract service station operators, and the operators themselves. These small businesses do not have the strength that comes from being well organized, and they do not have the financial resources to fight these issues effectively. Yet, as we point out in the attached statement, the position of the Internal Revenue Service—which it is seeking to apply retroactively—that the contract service station operators are employees rather than independent contractors, threatens their very existence. Truly, the actions of the Internal Revenue Service have served to place both the marketing companies and the service station operators on a list of "endangered species" of small business.

I am sure that these small business people will deeply appreciate your consideration of their problem as reflected in the attached statement.

Respectfully submitted,

RANDOLPH W. THROWER.

Attachment.

STATEMENT OF RANDOLPH W. THROWER, SUTHERLAND, ASBILL & BRENNAN, ATLANTA, GA.

A. SUMMARY OF POSITION

This statement is submitted on behalf of a group of small independent gasoline marketing companies which have engaged our law firm to represent them in connection with controversies with the Internal Revenue Service (the "Service") regarding the status of certain service station operators both for federal employment and withholding tax purposes and, in one case, for purposes of the qualification of a pension plan for company employees. The companies which we are representing, and their addresses, are listed below.

1. Big S Oil Co., Pensacola, Florida; 2. Dixie Oil Co., Tifton, Georgia; 3. Gate Petroleum Co., Jacksonville, Florida; 4. Pensacola Petroleum Co., Pensacola, Florida; 5. Rex Oil Company of Florida, Ft. Lauderdale, Florida; 6. San Ann Services, Inc., Boaz, Alabama; 7. Wavaho Oil Co., Lacey's Spring, Alabama; 8. Young Oil, Inc., Piedmont, Alabama.

We are making this special presentation on behalf of these companies because we feel that they are typical of many small, financially weak and often unrepresented businesses which are finding the resolution of this problem to be burdensome to the point of threatening their continued existence. The listed companies are small; the number of stations to which they supply gasoline ranges from 3 to just under 100. For several years they have been operating in a state of complete uncertainty as to the Service's concept of their relationships with station operators. They could readily adapt to Service requirements if they knew what they were. The competitive pressures on these companies from the major oil distributors are difficult enough. The added pressure from the Service is overwhelming. They cannot pay the proposed assessments; yet cannot afford to litigate these issues. Much lip service is given the objective of protecting small businesses while, in a very real sense, the pressures of this problem, unless removed, will certainly contribute to the demise of many of these small businesses. They should be placed upon an "endangered species" list for small businesses.

The small gasoline distributor is not the only threatened species today. Along with him will disappear the many independent small service station operators who are his contractors. The direct and indirect pressure of the Service is to facilitate tax collection by eliminating the independent status of the service station operator and converting these many small businessmen into employees. This has already occurred in many instances. The problem has by now developed to a point where strong Congressional direction is required to preserve and protect these important areas of small business.

The gasoline marketing companies listed above furnish gasoline to contract service station operators for sale to the public. The stations are operated under the listed company trademark. The gasoline marketing companies have consistently treated the service station operators under contract to them as independent small businessmen. In each case, the Service has taken the position that the contract station operators and the assistants they engage to help them are employees of the marketing company for employment tax purposes. Acceptance of this position would have the effect of preventing the marketing companies from treating the contract station operators as independent small businessmen. (One case, San Ann Services, Inc., has been resolved favorably by the Birmingham, Alabama District Office; the other cases are still pending.)

In one case, Pensacola Petroleum Co., the Service has also asserted that because of its position that the contract station operators are employees of the marketing company, they should have been covered by a qualified company pension plan. As a result, the Service has issued a "90-day letter" disqualifying the plan and forfeiting the benefits it affords to regular company employees. These employees include administrative and clerical staff and personnel who perform the daily operational tasks of the company. This small company, which for years had been following industry practice accepted by the Service, has thus been subjected to the financial burden of litigating this issue in the Tax Court.

In addition to the gasoline marketing companies listed above, our firm represents companies in the insurance, trucking, and certain other industries in connection with their pending employment tax disputes. Jerome B. Libin of our Washington, D.C. office has presented testimony to the Subcommittee primarily on behalf of our clients in the insurance industry, and his statement of position concerning S. 3037 and S. 3007 is generally adopted herein on behalf of our clients in the gasoline marketing industry.

To summarize our position, which is explained in more detail in Mr. Libin's testimony, we continue to urge Congress to act promptly to enact legislation providing a permanent solution to the growing problems in this area of the tax laws, which deals both with past and future years. If, however, there is insufficient time in this session to consider broad-scale legislation, we would generally support a temporary relief measure in line with S. 3007, introduced by Senator Dole, having general application to taxpayers in all affected industries *if* (1) the January 1, 1976 operative date in S. 3007 is changed to January 1, 1970; and (2) the bill is amended to provide clearly that retroactive assessments are to be permanently precluded in those cases where the taxpayer's prior practice of treating contract station operators as independent contractors was not challenged by the Service. At the very least, we believe that Congress should strongly urge the Commissioner of Internal Revenue to exercise the discretion granted to him under section 7805(b) of the Internal Revenue Code to apply, on a prospective basis only, following appropriate public notice, any audit position adopted after January 1, 1970 that constitutes departure from prior audit practice of accepting returns filed on the basis that the individuals in question were independent contractors.

We object to S. 3007 as introduced for two principal reasons. First, it affords no relief to most of the industries affected by this problem because of its January 1, 1976 operative date. General audits of employment tax compliance by taxpayers in the gasoline marketing and a number of other affected industries began in 1970. Indeed, the Service might interpret the bill as sanctioning the position it has taken in any employment tax audit commenced before January 1, 1976, even though such audit position may be part of the general Service effort in this area that led to the directive in the Conference Report accompanying the Tax Reform Act of 1976 (the "1976 Act").

Secondly, the ultimate effect of S. 3007 as introduced is unclear. It does not address the question of whether or not the IRS will be free to reassert its present audit position for back years whenever Congress finally enacts a law amending the definition of an "employee."

We also object to S. 3037, as introduced by Senators DeConcini and Haskell, because it would afford relief only to the real estate industry. Congress should provide relief to taxpayers in all affected industries.

B. DESCRIPTION OF METHOD OF OPERATIONS

Independent gasoline marketing companies are, in general, small businesses operating as an important part of the overall competitive structure of the petroleum industry. While there are some large independent gasoline marketing companies, most are quite small, and many have as few as three or four retail outlets. Their operations tend to be localized within a relatively small area or region where they play an important role in the overall economy of the various communities in which they operate.

The independent gasoline marketing company generally buys gasoline from a refiner, often an independent, and thereafter distributes it through distribution agreements with retail service station operators. Often, the gasoline marketing company owns or leases service station facilities which are leased or subleased to service station operators, usually referred to as "contract operators" or "dealers," who contract to sell gasoline supplied by the company. It is the status of these individuals as independent contractors which is being challenged by the Internal Revenue Service.

Because of their confidence in the ability of independent contractors to manage the station facilities and because of their desire to offer individuals the opportunity to enter business on their own without the burden of a large initial investment, many gasoline marketing companies offer gasoline to contract operators on a consignment basis. In the typical consignment operation, the station operator earns an agreed commission on each gallon sold. In many cases including cases for all the members of our group, however, commissions on gasoline sales are only a part of the contract operator's revenues, since gasoline is only part of his total marketing program. Substantial portions of the typical contract operator's income are derived from the sale of accessory products and services which are not provided by the gasoline marketing company. Under his lease the contract operator is entitled to, and usually does, sell various other products or services on the station premises. The lease contracts contemplate that these activities will be consistent with his obligation to market gasoline and protect the assets and trade name of the gasoline marketing company. The merchandise sold by contract operators engaged by the companies we represent includes fish bait and supplies, groceries and soft drinks, beer, cigarettes, tape recordings, used cars, automotive accessories, fuel oil, and virtually any type of merchandise. In addition, many operators perform mechanical work, both major and minor, wash cars, and provide other services.

The contract operator in all of these cases is responsible for employing the necessary attendants to pump gasoline, maintain the station, sell other goods, and perform whatever other services he chooses to offer. The contract operator has the responsibility for hiring and compensating whatever attendants or other personnel he believes are necessary to operate the station. He has the responsibility by law, and often reinforced expressly by contract, to meet Workmen's Compensation and employment tax obligations with respect to attendants he hires.

The contract operator's expenses are often substantial. In addition to labor expenses, items of expense may include the cost of nonconsigned goods; theft losses; burglar alarms and insurance; bad debt losses from bad checks and uncollectible credit accounts carried by the contract operator; advertising; office supplies; depreciation on station equipment owned by the contract operator; various state, county, and local licenses; and professional fees for bookkeepers and accountants. Some contract operators may also invest substantial sums in equipment, including garage equipment and tools, office equipment, and vending machines.

Some contract operators find that by employing a large staff they can engage in a number of non-gasoline related businesses on the service station premises, while other operators, for personal or other reasons, find that they prefer to have more limited business, and consequently do not employ a large staff of attendants. In either case the contract operator has the responsibility, consistent with his contractual obligations, to market gasoline supplied to him by the gasoline marketing company, to determine the hours he personally devotes to the business, the number of assistants he will employ and what he will pay them, and the range of products and services he will offer. The contract operator has substantial freedom to manage his own time, typically including the hours the station will be open within a reasonable range, and the hours he will be present.

In most cases, the only routine contract a contract operator will have with an employee of the gasoline marketing company is during a weekly, biweekly, or monthly audit of gasoline sales. These audits generally take less than an hour and are designed principally to confirm the amount of gasoline on hand and the amount of money owed by the contract operator to the gasoline marketing company on account of gasoline sales. Plainly, these limited audits are insufficient to establish "control" by the gasoline marketing companies.

C. THE HOUSE-SENATE CONFERENCE REPORT ON THE TAX REFORM ACT OF 1976

The Subcommittee is well aware that current Congressional concern with the status of workers in certain industries for employment tax purposes and the efforts of the Service to reclassify these individuals as employees on a retroactive active basis had its genesis in the Report of the Senate Finance Committee relating to the 1976 Act. Ultimately, the Conference Report on the 1976 Act, which was approved by the entire Congress, requested the Staff of the Joint Committee on Internal Revenue Taxation to study the employment tax area generally and instructed the Service not to apply any changed or newly stated position in the area until the Joint Committee Staff had completed its study. *See* H.R. Rep. 94-1515, 94th Cong. 2d Sess. 489 (1976); S. Rep. No. 94-938, 94th Cong. 2d Sess. 604 (1976); 122 Cong. Rec. S12495-96 (daily ed. July 25, 1976) colloquy of Senators Long and Curtis).

Unfortunately, during the nearly two years that have elapsed since Congress adopted the Conference Report on the 1976 Act, the Service does not seem to have fully accepted either the letter or the spirit of that request. Long-standing audits have been reversed, assessments have been proposed, and in some cases, assessments have been made.

One of our clients, Dixie Oil Company of Tifton, Georgia, is an unfortunate case in point. The Service approved Dixie's employment tax returns for 1969-70 and 1973 on the basis of separate audits conducted by two separate revenue agents in 1971 and 1974. During those years, Dixie supplied gasoline on a consignment basis to a number of station operators, whom it treated as independent small businessmen. There has been no material change in the relationship between Dixie and the independent station operators since the years approved on audit, yet a third examining agent has now proposed, on the basis of an audit of Dixie's 1975 employment tax returns begun in 1977, that these same station operators were Dixie's employees.

The Service is pursuing this case and seeking to impose this change in position retroactively, notwithstanding the taxpayer's position that the Service is precluded by the 1976 Act from proposing retroactive assessments in this case. As a result, the taxpayer is being required to incur burdensome legal expenses in its effort to protect itself from crippling retroactive assessments.

D. THE NEED FOR A BROAD GRANT OF NON-RETROACTIVITY

Two instances involving small businesses in the gasoline marketing industry further illustrate the need for a broad grant of non-retroactivity in the pending cases.

The first instance involves proposed retroactive assessments against three of our clients by the Birmingham, Alabama District Office of the Service. After thorough consideration of the facts and conference in the Review Division, the District Office determined that one of these companies, San Ann Services, Inc., had properly treated contract service station operators as independent contractors. Subsequently, however, the *same* District Office (with a different reviewer) determined that an employment situation existed with respect to the other two companies, Wavaho Oil Co. and Young Oil, Inc., even though it acknowledged that their contracts with station operators were modeled after, and were in substance identical to, the contract used by San Ann and that the factual relationship between the taxpayers and alleged employees was also substantially identical.

In the second instance, the Jacksonville, Florida District Office of the Service recognized that the station operators engaged by Rex Oil Company were independent small businessmen and assessed one of them for failing to withhold income and employment taxes on two station attendants he had employed. The station operator had filed Forms 1099 with respect to payments to his assistants. A Revenue Agent determined (correctly, we believe) that the attendants were employees of the station operator, and hence that the operator should have withheld and paid income and employment taxes on account of his assistants.

The station operator was forced to pay a retroactive assessment. A second Revenue Agent out of the same District Office has now proposed to treat the same station operator *and* his assistants (which he hired, supervised, and compensated) as employees of Rex. Two of the assistants the second Revenue Agent treats as employees of Rex were treated by the first Revenue Agent as employees of the station operator. The end result could be that the Service may collect income and FICA taxes due on account of the two station attendants three times—once from the individuals themselves, and then again from both the station operator and the marketing company. Similar inconsistent treatment by the Service of both the marketing company and a station operator as employers of the station operator's assistants has occurred in Dixie Oil Company's case.

The gasoline marketing companies listed above have for many years treated contract station operators as independent contractors consistent with the customary industry practice. They stand ready to comply with such obligations as they may have as collecting agents under the tax laws, but they should not be subjected to these obligations until they have been adequately notified of their responsibilities. One of these gasoline marketing companies, Rex Oil Company, demonstrated its willingness to cooperate by changing its operations, *at the suggestion of a Revenue Agent*, to permit its station operators to elect either to continue as independent contractors under a revised contract requiring the payment of a fixed rental to the company or to become salaried employees and subject themselves to the controls inherent in an employment relationship. Notwithstanding the Service has proposed a retroactive assessment against the company with respect to prior years' operations.

If relief is not granted for the pending cases, taxpayers will be forced into bankruptcy or time-consuming and expensive litigation. In the most recent judicial decision involving the status of contract service station operators for withholding and employment tax purposes, the station operators were found to be independent contractors in a consignment operation materially indistinguishable from the operations of our clients. *Star Oil Co.* v. *United States*, 1978–1 U.S.T.C. ¶9,160 (W.D. Okla. Dec. 16, 1977). This decision clearly demonstrates that the Service could expect for inconsistent results, at best in the ensuing litigation. Thus, the controversies would continue.

Our position that withholding obligations should be imposed on a prospective basis only, at least until taxpayers are given adequate notice of their responsibilities as collecting agents for the Service, is supported by the recent unanimous decision by the United States Supreme Court in *Central Illinois Pub. Serv. Co.* v. *United States*, 46 U.S.L.W. 4.163 (Feb. 28, 1978). The statements below, which are contained in the opinion delivered for the full Court by Justice Blackman and in the concurring opinions delivered by Justices Brennan (joined by Chief Justice Burger and Justice Powell) and Powell, are particularly instructive:

Because the employer is in a secondary position as to liability for any tax of the employee, it is a matter of obvious concern that absent further specific congressional action, the employer's obligation to withhold be precise and not speculative. (Blackman, J., at 11) (citing the statement in the Conference Report on the 1976 Act, discussed above. at H.R. Rep. 94–1515, 94th Cong., 2d Sess. 489).

* * * * * * *

The legislative history of the Internal Revenue Code does not reveal any evidence of congressional intent to make employers guarantors of the tax liabilities of their employees, which would in all likelihood be the result if withholding taxes can be assessed retroactively. (Brennan, J., concurring, at 2).

* * * * * * *

It seems particularly inappropriate for the Commissioner, absent express statutory authority, to impose retroactively the tax with respect to years prior to the date on which taxpayers are clearly put on notice of the liability. In other areas of the law "notice," to be legally meaningful, must be sufficiently explicit to inform a reasonably prudent person of the legal consequences of failure to comply with a law or regulation. In view of the complexities of federal taxation, fundamental fairness should prompt the Commissioner to refrain from the retroactive assessment of a tax in the absence of such notice or of clear congressional authorization. (Powell, J., concurring, at 1).

The principles enunciated by the Supreme Court in Central Illinois Public Service Co. Court should serve as a stimulus to enact legislation which will ensure that the Internal Revenue Service administers the withholding and employment tax laws in a fair and equitable manner. This will strengthen confidence in our tax system on the part of many small businessmen throughout the country.

E. THE INTERNAL REVENUE SERVICE'S POSITION IS CONTRARY TO THE GENERAL RECOGNITION OF CONTRACT STATION OPERATORS AS INDEPENDENT CONTRACTORS

The proposals by the Internal Revenue Service treat contract operators of service stations as employees come at precisely the time when other agencies and legislative bodies have recognized the importance of preserving the status of these individuals as independent businessmen. Several states have passed "dealer day in court" statutes, protecting the rights of contract service station operators as independent businessmen. The United States Supreme Court has recently upheld the constitutionality of a Maryland statute precluding producers and refiners of petroleum products from operating retail service stations in the state of Maryland with company employees rather than independent station operators. *Exxon Corp.* v. *Governor of Maryland*, 46 U.S.L.W. 4,662 (June 13, 1978). Additionally, the Federal Energy Administration resisted attempts by oil companies to force the conversion of independent station operators into employees. Moreover, the contract operators themselves jealously guard their status as small businessmen, and are proud of it.

The action by the Internal Revenue Service threatens to reverse this trend of general recognition of contract service station operators as independent contractors. We believe that such a result would be regretable because the service station business is one of the few where an individual may enter into business for himself, deriving the substantial satisfaction of earning a profit from the management of his own enterprise according to his own skills, ambition, and initiative, without the requirement of a major initial investment.

In 1948 and again in 1949, Congress acted to reaffirm the "common law" definition as the standard to be applied in determining whether an independent contracting or an employment relationship existed for employment tax purposes. According to the common law definition, an employment relationship is established when an "employer" has the right to control the "employee" in the details and means of performing the services; the right merely to specify the result to be accomplished is not inconsistent with an independent contracting status. This Congressional action was a response to those, including some in the Treasury, who had concluded that the Supreme Court's 1947 decisions in *United States* v. *Silk* and *Harrison* v. *Greyvan Lines, Inc.*, 331 U.S. 704, had sanctioned a broader "economic reality" test for determining employment status. Significantly, at that time the Joint Committee on Internal Revenue Taxation expressly stated its expectation that contract operators of service stations would be treated as independent contractors under the common law test. *See*, Sen. Rep. No. 1255, 80th Cong., 2d Sess. 9–10 (1948); H.R. Rep. No. 1300, 81st Cong., 1st Sess. 195–96, 207 (1949).

After knowingly acquiescing for a period of more than twenty years in the general understanding of the Congress and industry that contract service station operators are independent contractors, the Service, in 1969 and 1970, reissued two 1938 S.S.T.'s of questionable validity and with marked ambiguity which attempted to clasify at least some contract operators as employees. Rev. Rul. 69–305, 1969–1, C.B. 259: Rev. Rul. 70–443, 1970–2 C.B. 212: Rev. Rul. 69–305 found independence; Rev. Rul. 70–443 found employment. The rulings do not identify the factors in the relationship thought to be important by the Service, and they shed no light at all on the vast number of cases which contain elements found in each ruling.

The ambiguities and inconsistencies in the two rulings are numerous. For example, one of the differences cited by the Service is that the operator found to be independent in Rev. Rul. 69–305 "engages in his own name any persons needed to assist him . . .", while the employee-operator in Rev. Rul. 70–443 was "required to hire at his expense, such laborers and assistants as are necessary to accomplish the work . . . ." It is impossible for a businessman attempting to comply with tax requirements (or for that matter, his lawyer) to distinguish between these standards. Similarly, in Rev. Rul. 69–305 the independent contractor was found to be "not prohibited" from selling products supplied by competitors of the company, apparently not including the gasoline itself; but in fact the dealer sold no competitive merchandise, but only non-competitive items such as candy, gum, etc. By contrast, in Rev. Rul. 70–443 the "employee" operator was found to be prohibited from selling competitive items—which may well have been only gasoline—but no mention was made of what other, non-competing products he in fact sold or what other services he might have performed for customers in addition to pumping gasoline.

The 1938 S.S.T.'s which formed the basis of these rulings had never been withdrawn nor stated to be inconsistent with the prevailing industry practice for the 20-year period beginning with the 1950 revision to the Social Security Tax Act, and ending with the issuance of the 1969 and 1970 rulings. During this 20-year period, the Internal Revenue Service audited and accepted as filed the returns of the companies listed above and many other small gasoline marketing companies treating the contract operators as independent contractors. *Consequently, the reissuance of these 1938 rulings gave no suggestion that the Service had changed its audit position.* Nevertheless, based upon the reissued rulings, the Service in about 1970 began a program of auditing independent gasoline marketing companies and proposing enormous deficiencies based upon the companies' failure, in prior years, to treat contract operators as employees. Concurrently with its reissuance of the S.S.T.'s, the Service has placed reliance upon a "twenty factor" test of employment—a test which includes a number of the factors which made up the "economic reality" test and which, in legislation addressed specifically to that point, Congress decided should *not* be considered controlling in determining employment status. See *Aparacor, Inc.* v. *United States*, 556 F.2d 1004, 1013, 1019 (Ct. Cl. 1977).

F. THE NEED FOR GUIDELINES

The harshness of the Service's methods of procedure in this area is compounded by its consistent refusal to issue guidelines which would enable gasoline marketing companies to determine who are their "employees" for employment tax purposes. The need of the small gasoline marketing companies for guidance has repeatedly been called to the attention of the Service. Clearly, the two Revenue Rulings noted above, the only published position of the Service in the area, cannot be said to furnish such guidance.

This continued refusal to issue guidelines for the small gasoline marketing companies is premised on the notion that because each case is different, guidelines are not feasible. The Service's rationale does not suffice, however, for it is clear that guidelines with general applicability to a particular industry can be utilized even though each factual situation is, of necessity, somewhat different. The trucking industry is a case in point. There, after a careful industry study conducted in cooperation with certain segments of the industry, the Service issued guidelines to determine the nature of the relationship between a trucking company and truck drivers under contract to it. I. R. Manual 46(10)2. Such an approach by the Service contributed immeasurably to the revolution of pending employment tax questions for that industry as a whole. We believe that a similar approach would be beneficial both to the Service and to the many small independent gasoline marketing companies and have repeatedly urged the Service to take responsible action such as this. However, the Service has consistently declined to give any meaningful consideration to this proposal.

G. CONCLUSION

In summary, we believe that strong, effective Congressional action is crucial to the survival as independent small businesses both of the gasoline marketing companies listed above and the contract operators to whom they supply gasoline. We believe Congress should enact legislation providing a permanent solution as promptly as possible. If there is insufficient time to enact such a measure in the current session, we support a temporary relief measure in line with S. 3007, providing the operative date is changed so that it applies to audits begun after January 1, 1970, and further providing the bill is modified to provide clearly that retroactive assessments are to be permanently precluded in those cases where the taxpayer's prior practice was not challenged by the Service.

We appreciate the opportunity to submit this statement.

Respectfully submitted,

RANDOLPH W. THROWER.

ARIZONA ASSOCIATION OF REALTORS,
Phoenix, Ariz., July 20, 1978.

SENATOR DENNIS DECONCINI,
Senate Committee on Finance,
Dirksen Building, Washington, D.C.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE: We strongly support S. 3037, a bill recently introduced by Senator DeConcini, requiring the Internal Revenue Service to determine whether a real estate salesperson is an employee or independent contractor, without regard to Revenue Rulings 76-136 and 76-137, which were issued after December 1, 1975, or any other rulings reaching the same result or a similar result.

The issue of whether a particular worker is an employee or independent contractor is one of the fuzziest, most pervasive issues arising under the tax laws. On a yearly basis, tens of thousands of Americans are affected whenever the Internal Revenue Service unilaterally undertakes to decide this "Solomon like" question. Invariably, the Internal Revenue Service can retroactively apply its audit determination for at least a three year period, assessing federal income taxes, both halves of the Federal Insurance Contributions Act (FICA) taxes and Federal Unemployment Tax Act (FUTA) taxes against the purported employer. It is not uncommon for these tax assessments to exceed $100,000 or more. For the purported employee, the consequences can be equally inconvenient. Any person treating himself as an independent contractor and establishing and making contributions to a Keough plan as self-employed individuals are entitled to do, could have his plan disqualified by the Internal Revenue Service, thereby jeopardizing his retirement security.

Guidelines are contained in the Internal Revenue Code and the Regulations thereunder for determining whether a worker is an employee or independent contractor. Under the current statutory test, the independent contractor status may exist whenever the person for whom the services are performed does not control or retain the right to control or direct the individual who performs the services. See Treasury Regulations on Employment Taxes, Sections 3121, 3302 and 3401. Section 3121 of the Internal Revenue Code also provides that for purposes of FICA taxes, employee means anyone who under the usual common law tests has the status of an employee.

The Internal Revenue Service has adopted the twenty common law tests as contained in the Social Security Manual for making the employee-independent contractor determination. The real difficulty, however, starts with the fact that nowhere is it stated how many factors have to be satisfied to insure the independent contractor status. Worse, many of the common law factors are not susceptible of an objective application, and it is not unusual for the Internal Revenue Service and taxpayer to dispute whether a particular factor favors one status or the other.

There have been literally hundreds of decided cases, filed in the Federal Courts involving this issue. Unfortunately, these cases defy absolute symmetry. The real estate industry has been very fortunate however, in that all of the decided, reported cases that we could locate, held that the real estate salespersons involved were independent contractors. The best known of the trilogy of real estate cases is *Dimmitt-Rickhoff-Bayer Real Estate v. Finnegan*, 179 F. 2d 882 (8th Cir. 1950), cert. denied 340 U.S. 823 (1950). The Ninth Circuit, where cases from our own federal courts are appealed, decided this issue in favor of the independent real estate salesperson in *Henry Broderick, Inc. v. Squire*, 163 F. 2d 980 (9th Cir. 1947). Finally, the Federal District Court in Tennessee in *G. W. Allen & Co. v. Henslee*, 86 F. Supp. 295 (1949) decided that the real estate salespersons in question were independent contractors.

Despite these two appellate court decisions and the Supreme Court's denial of the government's Petition for Certiorari in the Dimmitt-Rickhoff case, the Internal Revenue Service does not appear content to recognize the independent contractor status under similar factual settings. The 1976 Revenue Rulings promulgated by the Internal Revenue Service appear to us to be an unwarranted misstatement of the law in an area of the law (the employment tax status of real estate salespersons), already settled by the earlier decisions.

As you are well aware, the real estate industry is populated by independent well-trained individuals who, by the very nature of their profession are required to be both aggressive and self-sufficient. Our state requires a rigorous examination before conferring a real estate sales license. Thus, based upon the day to day realities of their profession, real estate salespersons are forced to be very independent. The Eighth Circuit Court of Appeals made the following apropos remarks in summing up the facts in the *Dimmitt-Rickhoff* case "Here we are concerned with competent salesmen, almost entirely dependent upon their own initiative, efforts, skill, and personality for success, working upon their own time, at their own expense, and deriving their remuneration from the results of their work." What disturbs us more than anything else is why the Internal Revenue Service has singled out the real estate industry for implementing the overreaching Revenue Rulings 76–136 and 76–137.

We recognize that S. 3037 is an intermediate measure designed to maintain the status quo (as of December 1. 1975) until the Congress has an opportunity to make legislative changes in this area. We are also mindful of the General Accounting Office (G.A.O.) report prepared at the request of the Joint Committee of Taxation, analyzing this problem. Interestingly, the G.A.O. points out the Internal Revenue Service's concern that increases in the number of self-employed persons will result in lost tax revenues. Statistics compiled by the G.A.O., and even the Internal Revenue Service's own statistics, demonstrate that there are not substantially lower levels of compliance when the independent contractor status exists. This overconcern of the Internal Revenue Service for statistical levels of noncompliance is symptomatic of one of the problems in this area—the unwillingness or, at the least, the reluctance of the Internal Revenue Service to accept the independent contractor status, when in accordance with the accepted facts it legitimately exists.

For the time being, the Congressional mandate is clear—the independent contractor status is viable, and whenever the person for whom services are performed does not control or retain the right to control the services being performed, the person rendering those services is an independent contractor.

Sincerely,

BURT LEWKOWITZ, *Executive Vice President.*

CAPLIN & DRYSDALE,
Washington, D.C., July 31, 1978.

Senator HARRY F. BYRD, Jr.,
Committee on Finance, Subcommittee on Taxation and Debt Management, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR HARRY: I am enclosing a copy of my written statement in connection with the Committee's consideration of S. 3007 and S. 3037. Although I had planned to testify at the hearings, I spent July 24th in the hospital, attending to a minor health problem.

I consider the issues raised by S. 3007 and S. 3037 to be of great importance to the administration of the employment tax laws and am gratified to see your subcommittee taking the initiative in this area As was apparent at the hearings, however, the problem is much broader than the scope of these bills. I urge the Congress to adopt as an interim solution to the problem, legislation that would provide relief from reclassifications to all taxpayers. As more fully described in the enclosed statement, such legislation should bar the Internal Revenue Service from reclassifying individuals as employees in cases where the taxpayer has consistently and in good faith treated such individuals as independent contractors.

With warmest regards,

Sincerely,

MORTIMER M. CAPLIN.

Enclosures.

CAPLIN & DRYSDALE,
Washington, D.C., July 31, 1978.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. STERN: Enclosed are five copies of my written statement and summary in connection with the hearings on S. 3007 and S. 3037 held by the Subcommittee on Taxation and Debt Management on July 24, 1978.

The statement is submitted on behalf of the American Family Life Assurance Company of Columbus, whose headquarters are in Columbus, Georgia, and Clark Oil and Refining Corporation, of Wilwaukee, Wisconsin.

Sincerely,

MORTIMER M. CAPLIN.

Enclosures.

WRITTEN STATEMENT BY MORTIMER M. CAPLIN, CAPLIN & DRYSDALE, WASHINGTON, D.C.

SUMMARY

1. *General.*—Current administration of the employment tax laws is creating an imperative need for corrective legislation. Because of their complexity—involving issues of procedure as well as clear delineation of employment status—Congress probably will need a lengthy period of deliberation. During this period, an interim solution is required to alleviate severe hardships imposed on many taxpayers by the Internal Revenue Service.

As an interim solution, legislation is needed to bar the Internal Revenue Service from reclassifying an individual as an employee in cases where the taxpayer consistently and in good faith treated such individual as an independent contractor.

2. *Background.*—Beginning in 1971, the Internal Revenue Service dramatically altered its application of the employment tax laws. In an abrupt departure from existing case law and rulings, the Service has sought to reclassify as employees many persons who consistently and in good faith have been treated as independent contractors for tax and other business purposes. The Service has tried to accomplish this result by an aggressive and often distorted application of the common law employee test, thus creating an atmosphere of confusion and uncertainty.

S. 3007 and S. 3037 attempt to reverse the IRS action in reclassifying certain real estate salespeople as employees. However, the problem is not limited to the real estate industry. Many other industries and businesses—including insurance, gasoline marketing and direct selling, to cite just a few—are facing the same issue. Remedial legislation is needed to accomplish for all taxpayers what S. 3007 and S. 3037 attempt to do for the real estate industry.

3. *Reclassification Closely Resembles the Imposition of a Penalty.*—When a group of individuals has been treated as independent contractors, reclassification by the Internal Revenue Service requires the taxpayer to pay out of his own pocket taxes that he otherwise could have withheld from those individuals. Even if the Service's determination is ultimately reversed, prior disclosure of the potential liability in financial reports and the threat of liens on its assets impose severe hardships on taxpayers.

Moreover, reclassification poses special, and in some cases, insurmountable administrative problems for some taxpayers. For example, absent enabling legislation, an oil company which sells gasoline to service station dealers, but makes no payments to them, has nothing in its possession from which to withhold taxes. Reclassification here would pose an insoluble dilemma.

4. *There Is A Need for Immediate Relief From IRS Reclassifications.*—Relief for taxpayers with pending cases, or cases which may arise under current law, cannot wait until Congress finally resolves the employee-independent contractor problem. Many are operating under the threat of huge assessments and have incurred substantial legal and administrative expenses in defending their cases. If relief is not forthcoming, some of them might ultimately be liable for such overwhelming amounts of employment taxes that their financial viability would be threatened.

Nor is it sufficient to place all pending cases in suspense. Many of these cases involve taxable years dating back to the 1960's. If they ever have to be tried, the chances of obtaining reliable evidence diminishes with every passing day. Moreover, since employqment tax liability is a continuing one, a taxpayer's potential liability would accumulate during the full suspense period.

5. *Proposal.*—I therefore urge the Committee to adopt legislation to provide that an individual will not be treated as an employee of any person for purposes of Chapters 21, 23, and 24 of the Internal Revenue Code of 1954, if such person, in good faith, consistently treated such individual or the class of individuals of which he is a member as independent contractors for such purposes. The legislation should apply to all open years until it is expressly repealed by the Congress.

WRITTEN STATEMENT BY MORTIMER M. CAPLIN, CAPLIN & DRYSDALE, WASHINGTON, D.C.

I welcome the opportunity to file this statement with the Committee to discuss S. 3007 and S. 3037, dealing with the Internal Revenue Service's administration of the employment tax laws. It is submitted on behalf of two clients, an insurance company and an independent oil company, each with an employee-independent contractor case pending before the Internal Revenue Service.

BACKGROUND AND GENERAL COMMENTS

Description of the problem

Over the past several years the Internal Revenue Service has dramatically altered its application of the employment tax laws. In what the Court of Claims recently characterized as an "abrupt departure from existing case law and rulings," [1] the Service has sought to reclassify many persons who have traditionally been treated as independent contractors. This has been attempted through an aggressive and often distorted application of the common law "employee" test, thus creating an atmosphere of confusion and uncertainty. As a result, severe hardships have already been imposed on numerous taxpayers—from small independent businesses to large corporations—and countless others are encountering similar threats.

S. 3007 and S. 3037 attempt to reverse the action of the Internal Revenue Service in reclassifying certain real estate salespeople as employees. The problem, however, is not limited to real estate. Many other industries and businesses—including insurance, gasoline marketing and direct selling, to cite just a few—are facing the same issue.

Various oil companies, for example, consistent with industry practice, have for many years openly treated the dealers who purchase their gasoline as independent contractors for employment tax and other purposes. In a similar fashion, many insurance companies have contracted with independent insurance agents to sell their policies and have treated those agents as independent contractors. As a result of Internal Revenue's current attempt to reclassify service station dealers and insurance agents as employees, these companies have been operating under the threat of exceedingly high employment tax deficiencies. Not only have they had to disclose sizable contingencies to shareholders and the public, but they have incurred substantial expenses in defending their cases. Also, serious disruptions are occurring in their relationships with dealers as a result of the Service's contacts and continued questioning of these parties.

Remedial legislation is imperatively needed to deal with the problems caused by current IRS administration of the employment tax laws. In a report issued to the Joint Committee on Taxation on November 21, 1978, the General Accounting Office recognized many of the difficulties and proposed legislative solutions.[2] In turn, the Chairman of the House Ways and Means Committee recently appointed a Task Force on Employment Taxes to study the issues and to make recommendations. And the staff of the Joint Committee on Taxation, pursuant to a request of the Finance and Conference Committees (made in connection with the Tax Reform Act of 1976), also has a study project underway.

While problems of both procedure and definition must be resolved, the definitional aspect is patently the most difficult. Whether the common law test is retained or a new test adopted, the delineation of relationship-patterns which constitute "employment" must be made clear. The task is extremely complex—involving a wide diversity of businesses and types of inter-party arrangements—and we probably must anticipate a lengthy process of deliberation before substantive legislation is enacted. Nevertheless, as this issue goes to the very heart of our withholding tax system, its resolution merits high ranking on the Committee's list of priorities.

Need for an interim solution

During this deliberative period, a procedural remedy must be provided to deal with pending cases or new cases arising under IRS administration of current law. In connection with the Tax Reform Act of 1976, members of the Senate Finance and Conference Committees recognized the need for an iterim solution.

[1] *Aparacor Inc.* v. *United States*, 556 F.2d 1004, 1018, n. 41 (Ct. Cl. 1977).

[2] *See*, "Tax Treatment of Employees And Self-Employed Persons By The Internal Revenue Service: Problems and Solutions" (GGD-77-88).

Both Committees urged that until the Staff of the Joint Committee on Taxation had completed its study "the Internal Revenue Service not . . . apply any changed position or any newly stated position which is inconsistent with a prior general audit position in this general [employee-independent contractor] subject area to past, as opposed to future taxable years."[3] However, as Internal Revenue has given no evidence of acquiescing to this plea, legislation is now necessary—to accomplish for all taxpayers the results intended by the Finance and Conference Committees, not for just the real estate industry alone.

I suggest legislation similar to that introduced in the House of Representatives by Congressman Panetta on June 28, 1978 and styled H.R. 13313. Under subsection (b) of that bill, until Congress resolves the definitional problem, the Internal Revenue Service would be barred from reclassifying an individual as an employee if the taxpayer has, under current law, consistently and in good faith treated such individual as an independent contractor for employment tax purposes. My recommendation and reasons are more fully described below.

THE HARSH CONSEQUENCES OF RECLASSIFICATIONS

As a matter of equity and sound administration of the tax laws, the suggested legislation is particularly appropriate to deal with the problem at hand. Employment tax assessments are very different from income tax assessments. In fact, particularly in these reclassification cases, they more closely resemble civil tax penalties.

When the Internal Revenue Service determines that, for employment tax purposes, individuals never previously treated as employees should have been so regarded, hardships and inequities arise which are not present in income tax cases. If an employer knows in advance of its responsibility to withhold both income taxes and the employee's share of FICA taxes, it can in fact withhold from its employees' wages at payment time. However, if the workers have been treated as independent contractors, income or FICA taxes will not have been withheld. And it will then be too late for withholding if the Service's retroactive determination is upheld. In many such cases, it is virtually impossible for the taxpayer to prove actual income tax payment by reclassified individuals or to collect taxes from them. Rather than "simply acting as a collection conduit for the United States",[4] the taxpayer will be required to pay substantial amounts out of its own pocket.

Even if the Service's determination is ultimately reversed in litigation, likely to happen in many cases, prior disclosure of the potential liability in its financial reports will impair the taxpayer's ability to raise capital, borrow money, or take advantage of business opportunities. Further, during the pendency of this type of tax litigation the taxpayer would be subject to tax liens for the unpaid, disputed tax liability, or it would be obliged to incur the substantial cost of posting bonds or collateral. In sum, in the typical employee-independent contractor case, a retroactive assessment is a penalty in all but name, imposed regardless of the taxpayer's reasonableness or good faith.

The potential liabilities are staggering in the employee-independent contractor cases now pending before the IRS and federal courts. The Commissioner of Internal Revenue has indicated that "at the present time in two districts of one region alone there are three potential assessments against taxpayers ranging from $6 million to $60 million, involving an insurance company, an oil jobber and a direct sales company."[5] In a recent employee-independent contractor case involving a direct sales company, the Court of Claims noted the "understandable alarm on the part of plaintiff that its business and the industry of which it is a part are . . . threatened with destruction."[6]

Other major industries, such as insurance and oil, are also seriously threatened. In connection with its change of position, the IRS has already reclassified many insurance agents and service station dealers as employees of the companies whose products they sell. It should be noted that, if IRS reclassified all insurance agents as employees of insurance companies whose policies they offer for sale, and all

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[3] H.R. Rept. No. 94-1515, 94th Cong., 2d sess., 489. *See also* S. Rept. No. 94-938, 94th Cong., 2d sess., 604; Remarks of Senator Long, 122 Cong. Rec S12496 (1976).

[4] *Central Illinois Public Service Co. v. United States*, 46 U.S.L.W. 4163, 4167 (February 28, 1978) (Brennan, J. concurring).

[5] "Remarks by Jerome Kurtz, Commissioner of Internal Revenue before the American Bar Association Annual Meeting," August 6, 1977.

[6] *Aparacor, Inc. v. United States*, 556 F.2d 1004, 1018, n. 41 (Ct. Cl. 1977).

service station dealers as employees of oil companies supplying them with gasoline, proposed assessments for prior years' taxes would aggregate billions of dollars.

ADMINISTRATIVE PROBLEMS FACED BY TAXPAYERS

Reclassification by the Internal Revenue Service poses for many taxpayers special, and in some cases insurmountable, administrative problems. For example, most service station dealers are not paid by the oil company supplying them with gasoline. They earn income by purchasing gasoline at wholesale and reselling it at a profit. However, if the Service reclassifies a dealer as an employee, it treats his gross (rather than net) profits as "wages" for employment tax purposes. Similarly, if the Service reclassifies an insurance agent as an employee, "wages" are his gross rather than net commission income. In reclassification cases, the IRS thus does not permit the alleged employer to deduct the business expenses of the alleged employees in computing "wages", even though these individuals pay income taxes only on net rather than gross income. In contrast, if an employer had been apprised of its liability for employment taxes when "wages" were paid, it would have been able to compute such taxes only on the net earnings of the employee. *See*, Rev. Rul. 73–260, 1973–1 C.B. 412.

An oil company typically sells gasoline to dealers for a given sum, but neither pays them anything nor knows their resale prices. It is therefore impossible for the company to determine accurately even the gross profits of a dealer.

There is yet another penalizing aspect when service station dealers are reclassified as employees; the oil company has nothing in its possession from which to withhold taxes, and dealers would unquestionably resist company attempts to collect tax dollars from them. Moreover, since the wholesale price of gasoline is regulated by the Department of Energy (which treats dealers as independent contractors), the company could not handle the matter simply by raising prices. Further, under existing contracts and other legal protections afforded to dealers, many oil companies are not in a position to alter their dealer-relationships to create a payment flow available for withholding.

Although insurance companies in fact make commission payments to insurance agents, the gross amount under existing contracts belongs to the agents. Thus, absent enabling legislation or a final court decree, an insurance company would be hard pressed to withhold taxes merely on the basis of an IRS claim of an employment relationship.

Finally, the inequities accompanying reclassifications are not limited to the employment taxes alone. Reclassified individuals, under the belief that they are independent contractors, may have contributed to self-employed pension plans (H.R. 10). In turn, the Service, on the basis of finding an employer-employee relationship, might disqualify these plans retroactively, and assess the individuals for additional income taxes on prior years' contributions and earnings of the plans. Similarly, many companies, having consistently and in good faith treated these individuals as independent contractors, may find their own qualified pension plans to be discriminatory because of the non-coverage of individuals now being reclassified as employees. Retroactive disqualification of these plans would lead to sizable and widespread income tax assessments.

ECONOMIC AND SOCIAL CHANGES FOISTED ON TAXPAYERS

The IRS' reclassification program is aimed at groups of individuals who have traditionally been regarded as independent businessmen—by themselves, fellow-tradesmen, the public and other government agencies. These individuals take pride in their status as independent entrepreneurs; and many attribute their success to their independent operations and their individual decision-making.

If the Service's goals are attained, established economic and social relationships will be threatened. This would be true for a broad category of individuals who consistently and in good faith have been treated as independent contractors for tax and other business reasons.

BURDEN IMPOSED BY IRS PROCEDURE FOR OFFSETTING PREVIOUSLY PAID TAXES

Under present law, if the IRS reclassified individuals whom the taxpayer has previously treated as independent contractors, the taxpayer is entitled to offset against its potential tax liability the individuals' payments of income and, in some cases, SECA taxes. However, the IRS procedure for "netting out" previously paid taxes is incredibly harsh and frequently results in collecting the same tax twice.

If the taxpayer wants to have the assessment reduced by previously paid taxes, it must do so on its own. Without any assistance from the IRS, the taxpayer must locate the reclassified individuals and ask them to execute IRS Form 4669, certifying that they reported the income and paid taxes. To the extent that they refuse to sign or cannot be located, then the taxpayer must itself pay both income taxes and the employee's share of FICA taxes, even though it is likely that a large portion of these taxes has already been paid.

This indefensible practice is a by-product of the IRS's current attitude on the employee-independent contractor issue, and is another reason supporting the need for a legislative change.

THE COMMISSIONER'S CHANGED POSITION

The inequities and administrative problems discussed above have been compounded by the post-1970 sharp changes in IRS handling of employee-independent contractor cases.

A stark example is provided by the IRS announcement in testimony before this Subcommittee on July 24, 1978, that Revenue Rulings 76–136 and 76–137, dealing with the status of real estate salespeople, were being withdrawn (presumably with retroactive effect). As these are the very rulings that led to the introduction of S. 3007 and S. 3037, their withdrawal delivers a very clear message: (a) it reflects the confusing uncertainties that abound in this area, and (b) it illustrates the shifting IRS positions which are creating so much difficulty.

Since 1971, taxpayers in other industries have encountered comparable changes in the Internal Revenue Service's position. Today it is clear that these changes involve more than simply increased return examinations; rather, they are undeniably changes of substance. Published rulings and prior IRS litigating and audit positions have been disregarded. In effect, the Internal Revenue Service has redefined the common law employee test to suit its own policy goals—to extend withholding to large groups of the self-employed, without legislation authorizing that result.

These IRS goals seem far removed from what Congress intended when it tied the employment tax laws to the common law employee test. Certainly there is no justification in shifting the rules on a retroactive basis.

PROPOSALS

Legislation is now necessary to protect all taxpayers—not just real estate salespeople—from retroactive reclassifications of status. In addition to clarifying the law, Congress must also provide for fair transitional rules so as to avoid hardships and inequities for taxpayers who have acted in good faith.

Relief for taxpayers with pending cases or cases which may arise under current law cannot wait until Congress finally resolves the employee-independent contractor problem. Many are operating under the threat of huge tax assessments. Others have had liens filed against them while they contest the asserted liability. As the employee-independent contractor issue is heavily factual, these taxpayers must necessarily incur substantial legal and administrative expenses to prepare and defend their cases. And, if relief is not forthcoming, some of them might ultimately be liable for such overwhelming amounts of employment taxes that their financial viability would be threatened.

Nor is it sufficient to place all pending cases in suspense. Many of these cases involve taxable years dating back to the 1960's. If they ever have to be tried, the chances of obtaining reliable evidence diminishes with every passing day. Moreover, since employment tax liability is a continuing one, a taxpayer's potential liability would accumulate during the full suspense period.

I therefore urge the Committee to take the following action:

A. The Committee should adopt legislation providing that: An individual will not be treated as an employee of any person for purposes of Chapters 21, 23, and 24 of the Internal Revenue Code of 1954, if such person, in good faith, consistently treated such individual or the class of individuals of which he is a member as independent contractors for such purposes.

B. The legislation should apply to all open years until it is expressly repealed by the Congress.

C. The legislation or the accompanying committee reports should also make it clear that a taxpayer would be deemed to have acted in good faith if he relied on factors such as (1) the Commissioner's prior audit and litigating practices; (2) published rulings and cases; (3) judicial decisions in non-tax cases involving the same common law employee test applicable in the employment tax area; (4) the practice in the industry generally with respect to the treatment for tax and other purposes of the individual or class of individuals whose status is in question; and (5) longstanding reporting positions.

CONCLUSION

To resolve the reclassification problem for cases arising under current law, Congress must strike a sensible balance between considerations of equity for taxpayers and proper tax administration by the IRS.

The proposal outlined above would achieve this goal. On the one hand, it permits assessments where taxpayers negligently or intentionally failed to carry out clear obligations imposed on them under the employment tax laws. On the other, assessments are precluded where taxpayers, with good faith reason to believe that individuals were independent contractors, found themselves ensnared by Internal Revenue's change in position.

The proposed legislation would resolve a difficult and far-reaching administrative dilemma and would provide an immediate solution that is fair both to the affected taxpayers and to the Internal Revenue Service.

STATEMENT OF JOSEPH J. LYMAN

Mr. Chairman, members of the Committee, my name is Joseph J. Lyman, and I am a member of the Bar of the District of Columbia.

My office currently represents, in litigation, approximately fifty commercial fishing boat owners conducting their seafaring operations off the Atlantic coast and in the Gulf of Mexico.

Substantial deficiencies in federal employment taxes[1] have been assessed against these commercial fishing operators for varying periods reaching as far back as 1966 and up to and including 1973. The deficiencies were computed on the earnings of the captains and crewmen aboard the fishing vessels as though they were the operators' employees. Traditionally and realistically these and other operators considered the seafarers aboard their trawlers to be self-employed persons or independent contractors for employment tax purposes. As a consequence, the operators did not withhold or pay over employment taxes on their earnings to the Internal Revenue Service. To the contrary, these commercial fishermen were paid the full amount due them following division of the proceeds of their fish catches with the boat owners. The boat owners filed Treasury Department forms 1099 with the IRS over the years, informing it of the principal-independent contractor arrangement between the owners and the fishermen.

To avoid summary collection by the IRS, which would have spelled ruin or bankruptcy for these operators, partial payments of these employment taxes were made to the IRS. Claims for refund procedures followed, resulting in law suits for such refunds following notices of claim disallowance from the IRS. These cases were pending in the courts when the boat operators' plight came to Congress' attention during its consideration of the Tax Reform Act of 1976.[2]

Section 1207(e) of the Tax Reform Act of 1976 amended various employment tax sections of the Internal Revenue Code to remove certain fishermen from the "employee" class into that of "independent contractor" for federal employment tax purposes. The effect of the amendment was to create an independent contractor status for captains and crewmen aboard commercial fishing vessels, whose crews (including the captain) were composed of ten or less individuals, and whose only renumeration was a share of the proceeds from the sale of their fish catches.

In treating these relationships as instances of employment by boat operators prior to the 1976 Tax Reform Act, the Internal Revenue Service not only required

[1] Federal Insurance Contributions Act taxes, Chapter 21, Internal Revenue Code (FICA or Social Security taxes); Federal Unemployment Tax Act taxes, Chapter 23 (FUTA) (for unemployment insurance purposes); and Collection of Income at Source on Wages, Chapter 24 (income withholding taxes).

[2] Public Law 94-455, § 1207(e)(1)(A) and § 1207(f)(4)(e) of the Tax Reform Act of 1976.

current payment of employment taxes on the crew's earnings, but also assessed these taxes retroactively for all years still open under the statute of limitations at the time of audit.

The 1976 amendment provided for tax treatment of the captains and crewmen as self-employed persons under the circumstances described above and granted relief from retroactive assessments with respect to services performed after December 31, 1971. The Congress believed that complete relief had been accorded operators for all years under the statute of limitations.

Following enactment of the amendment, it was revealed that a large group of operators were still under assessment for years prior to December 31, 1971 by virtue of waivers of the limitations statutes having been obtained in earlier audits. The Congress responded quickly to rectify this oversight by the provisions of Section 2(aa) of the Technical Corrections Act of 1978 (H.R. 6715), which would ride the relief provisions from December 31, 1971 back to December 31, 1954. That bill is pending in Conference Committee. We understand that no objection has been interposed by any member respecting the commercial fishing relief provisions.

The 1976 Tax Reform Act amended Internal Revenue Code Section 3121(b) (defining "employment" under the Federal Insurance Contributions Act); Section 3401(a) (defining wages" for purposes of withholding); and Section 1402(a) (defining "trade or business" under the Self-Employment Contributions Act), but neglected, through oversight, to amend Section 3306(c) (defining "employment" under the Federal Unemployment Tax Act).

S. 3080 would correct this oversight and inequity by amending Section 3306(c) to conform to the self-employment status given fishermen under the Federal Insurance Contributions Act, Collection of Income Tax at Source on Wages Act, and Self-Employment Contributions Act.

One of the primary reasons Congress accorded commercial fishermen the change in status was the realization that it was difficult and impractical for a boat operator to keep the necessary records to calculate tax obligations as an employer and it was equally difficult for him to withhold the appropriate taxes for payment over to the government.[3] The Report of the Senate Finance Committee on the Tax Reform Act of 1976 further pointed out that commercial fishing boat operators were unaccustomed to keeping records of any type, especially the type required under the rigid tax rules for employers.[4]

Congress oversight in omitting the Federal Unemployment Tax Act from the 1976 Tax Reform Act amendments created a dilemma whereby it imposed heavy paperwork on the operators in complying with federal and hence state unemployment insurance tax requirements. Obviously, Congress intended full relief from these obligations. S. 3080 will correct this deficiency. By enactment of S. 3080 operators will be given the complete relief originally intended. It would be a strange law indeed which undertook to create independent contractors for all intents and purposes and then permit them to stand in line as "employees" at the uemployment insurance check window.

In order to bring the provisions of S. 3080 into conformity with the amendments contained in the Technical Corrections Act of 1978 (H.R. 6715), the provisions of S. 3080 should be made effective with respect to services performed after December 31, 1954, in taxable years ending after that date.

I appreciate this opportunity to address the Committee on this important matter.

Statement of Randolph J. Seifert, Vice President and General Counsel, National Home Improvement Council

My name is Randolph J. Seifert. I am Vice President and General Counsel of the National Home Improvement Council. This statement is submitted in connection with the consideration by your committee of S. 3007 and S. 3037.

The National Home Improvement Council is a trade association representing more than 40 national members who are primarily engaged in manufacturing products for the construction and residential building industries. These national members also include a number of shelter publications dealing with the home and the many concerns of the homeowner.

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[3] S. Rept. No. 94-938, p. 385.
[4] Ibid.

The Council has 40 local chapters extending from New York and Washington in the East to Seattle and Los Angeles in the West. These chapters number more than 2,000 contractors engaged in home remodeling and improvement. The local membership also includes lending institutions, utilities, and wholesalers.

These contractors are almost exclusively small businesmen with a relatively small number of employees. In order to accomplish the work of the industry, the traditional practice has been to utilize subcontractors with a variety of skills: plumbers, sheet metal workers, and brick masons, to name a few. There are approximately 20 of these recognized skills helping the typical home improvement contractor to perform his function.

In addition, a second type of relationship exists in this industry. Independent salesmen work for one or more home improvement contractors to provide the business input on which the home improvement contractor depends. These salesmen are independently active and generate business for one or more remodelers on a contractual basis.

This industry very much applauds the basic concept behind S. 3007 and S. 3037, but would hope that this committee would recommend legislation with a broader scope. We respectfully join in the suggestion that all industries be afforded the protection S. 3037 would extend to real estate brokers, and urge that the thrust of the proposed legislation be extended to all industries affected.

Utilization of a cutoff date of January 1, 1976 in S. 3007 unduly restricts that proposed legislation for most of the industries concerned with this problem. The cutoff date should be no more recent than January 1, 1970 as suggested by the insurance industry in its presentation to your committee.

We endorse The Direct Selling Association's suggestion of an approach similar to that of HR13313, as a substitute for S. 3007 and S. 3037. That proposal would afford better protection from excessive IRS activity during the period when Congress might be considering a more permanent solution to this overall problem.

The statement of Congressman Panetta that this Subcommittee "move quickly to provide immediate relief to literally thousands of businesses who are being harassed by these arbitrary and inconsistent IRS audits", is most appropriate. Our industry is very much affected by IRS activity that varies from district to district, and often results in catastrophic retroactive assessments and unjustified double taxation. Some interim protection is vitally needed.

Finally, we sincerely hope that the views and recommendations of the General Accounting Office Report to the Joint Committee on Taxation of November 21, 1977 be given serious consideration in arriving at a long term solution to the independent contractor-employee tax problem.

This opportunity to express these views on a problem of very real interest to our industry is much appreciated.

MILLER HOME OF LYNCHBURG, VA.,
Lynchburg, Va., July 19, 1978.

Hon. HARRY F. BYRD, JR.,
Senator of the United States,
Washington, D.C.

DEAR SIR: We are writing to support the enactment of S-2825, which we understand will have the effect of removing the excise tax on charitable homes for children.

We have been operating a home for children for many years in this community. During the last several years, since we were subject to the excise tax as a private foundation, we have had to pay a total of $17,269 which could have been spent for the care of the children for whose benefit the home was established.

The members of our Board give hours of work to shaping our policies and supervising the operations of this institution, without compensation.

In our opinion the excise tax has operated in a manner of which has been discriminatory and harmful to public interest, and urge the enactment of legislation effecting its repeal.

Respectfully submitted,

DR. WILLIAM E. PAINTER,
President of the Board of Directors.

THE WILLIAMS HOME, INC.,
Lynchburg, Va., July 19, 1978.

HON. HARRY F. BYRD, JR.,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: We appreciate your informing us of the hearing on S2825 which we understand will have the effect of removing the excise tax on charitable homes for elderly persons, of which we are one.

We have been operating during the last few years at a deficit so that no income tax would have been required if the Home had been a non-charitable entity; nevertheless, we have been required to pay by way of excise tax a total of $50,567.00 which could have been spent for the care of the elderly persons in the Home.

The members of our Board give hours of work shaping the policies and supervising the operation of this facility, all without compensation.

We feel that the excise tax has been iniquitous, discriminatory and harmful to the public interest, and we urge the enactment of legislation effecting its repeal.

Respectfully submitted,

LEWIS B. GOODE, JR., *President.*

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation, the largest general farm organization in the United States, is pleased to support S. 3125, a bill that would take another step toward the more equitable tax treatment of the heirs to farm property.

The 1976 Tax Reform Act gave much needed relief to farm families throughout the country by providing that the value of a farm for estate tax purposes can be based upon its current use as a farm rather than on its potentially higher value as a housing development or a shopping center. A valuation based upon the highest and best use meant financial hardship for many individuals who were already faced with the prospect of having to sell the farm to pay estate taxes.

S. 3125 goes a step further and prevents inequitable capital gains tax treatment of heirs when farmland is involuntarily converted to a nonqualifying use, such as a highway project, during the 15-year recapture period. By allowing devisees to reinvest the proceeds of the involuntary conversion of farmland in farm property of equal value, the tax code would provide a favorable capital gains treatment similar to that now available in the case of the sale of a taxpayer's principal residence.

Farm Bureau supports the capital gains treatment that would result from this technical change in the estate tax laws. The voting delegates of the member State Farm Bureaus to the 58th annual meeting of the American Farm Bureau Federation in January, 1978, adopted the following policy which is in support of the objective of S. 3125:

"Where farmland is acquired for public use by eminent domain or private treaty, the owners should be permitted to reinvest in farming or another business with the same tax treatment..."

Farm Bureau favors an adjustment to the carryover basis, as proposed by S. 3125, for the amount of tax recaptured where there has been no replacement of the special valuation use property. This position is consistent with that which exists for a basis adjustment for estate tax attributed to the appreciation of property. While Farm Bureau is on record as favoring the complete repeal of the carryover basis rules of the 1976 Tax Reform Act, it is eager to see a modification in the rules as proposed in S. 3125.

The changes that S. 3125 would make in the tax treatment of involuntarily converted real property, both through the reinvestment provision and the adjustment to carryover basis, will lead to greater tax equity for many farm families who have devoted their lives to agriculture. We urge the Subcommittee to act favorably on this legislation.

SHANNON AND LUCHS,
Washington, D.C., July 24, 1978.

Re Support of legislation to continue long-standing IRS rules defining employment relationship.

Hon. HARRY F. BYRD, Jr.,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: I am writing to you on behalf of the Shannon & Luchs Company to express our support for S. 3007, S. 3037 and any other similar bills, which would bar the Internal Revenue Service, for a temporary or indefinite period, from departing from its long established rules defining whether an individual is an employee for purposes of income tax withholding and various payroll taxes.

We are pleased to see that these bills will be the subject of a hearing on July 24 before the Subcommittee on Taxation of the Finance Committee, and urge you to give them your support.

ABOUT SHANNON & LUCHS

In addition to its management, leasing, and mortgage financing activities as a full-service real estate firm, the Shannon & Luchs Company is engaged in the sale, as a broker, of residential and commercial real estate in the District of Columbia and suburban Maryland and Virginia. It is one of the largest real estate brokers serving the metropolitan area.

Shannon & Luchs maintains a residential sales force of more than 600 persons. Under long-established IRS ground rules, Shannon & Luchs has entered into agreements with these sales personnel confirming their status as independent contractors. These persons establish their own hours and their own methods for selling real estate, and are paid wholly on a commission basis. They pay the cost of their own retirement and health insurance programs, if desired. The Shannon & Luchs Company provides them with training opportunities and leads, as well as with office space and certain administrative support, but the extent to which they make use of such resources is entirely up to them. As independent contractors, the sales persons are not subject to withholding of federal income taxes or social security taxes, nor are they subject to federal unemployment taxes.

ESTABLISHED IRS RULES

For more than 25 years, the IRS has followed the decision of the United States Court of Appeals for the 8th Circuit in the *Dimmitt-Rickhoff-Bayer*[1] case. This is the leading case recognizing the independent contractor status of real estate salespersons who did business in the name of a broker and were provided with office support, but who were not required to keep any fixed hours and who had no guaranteed compensation.

In reliance on this case, a major portion of the brokers and salespersons in the United States real estate brokerage industry have structured their business operations to treat real estate salespersons as independent contractors.

Any change in these long-established ground rules by IRS audit action involves extreme potential liability to companies held to be employers. Millions of dollars may be due in back income taxes not withheld, even though the "employees" may in fact have paid all income taxes due. Large additional liabilities may be asserted against the "employer" for both the employer's and the employee's shares of social security taxes, as well as for unemployment taxes. All of these taxes may be asserted going back several years.

In addition, although Shannon & Luchs no longer maintains an employee pension plan, many firms will find that beyond these enormous potential tax liabilities, their pension plans may be held to lose their qualified status under ERISA, because they have excluded large numbers of persons now held retroactively to be employees.

Finally, for the same reason, retirement contributions set aside by the sales persons held to be employees, in "H.R. 10" plans and IRA's, may also be disqualified, resulting in major tax liability to these persons.

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[1] *Dimmitt-Rickhoff-Bayer Real Estate Co.* v. *Finnegan,* 179 F. 2d 882 (8th Cir. 1950), cert. denied 340 U.S. 823 (1950). See Mim. 6566, 1951-1 C.B. 108, 109, following the *Dimmitt* case, and revoking an earlier ruling to the contrary.

Employers already face these risks, if it is held that they did not in practice conform with the guidelines established in the *Dimmitt* case. However, this is by now an acceptable risk, since the *Dimmitt* facts represent a well-known pattern.

Notwithstanding this 25-year history, the Internal Revenue Service in Rev. Rulings 76–137 and 76–138 (1976–2 C.B. 312, 315) redefined the *Dimmitt* rules very narrowly, thereby introducing great uncertainty. Through intensified tax audits, the Service translated this uncertainty into major tax liability for many brokers, effectively changing the legal ground rules retroactively by administrative fiat.

Thus, Revenue Ruling 76–137 holds that the *Dimmitt* case will be followed on its own facts, but Revenue Ruling 76–138 held that real estate sales agents are employees where, on facts otherwise similar to *Dimmitt*, it was also shown that the broker sponsored prospective sales agents for the state licensing registration, supervised the work of new or unproductive agents, required follow-up reports on company-provided "leads," required agents to keep company-arranged appointments, and paid a minimum guaranteed draw. Some of these practices characterize many firms in the industry, especially those relating to sponsorship for state license registration, and in light of this ruling, it is feared that the Service may seize upon numerous other facts to justify an "employee" finding, even though the *Dimmitt* facts are also present. Accordingly, this ruling has created great uncertainty and threatens many firms with extreme retrospective tax penalties on audit.

The Senate Finance Committee, in its report [1] on the Tax Reform Act of 1976, stated that it had directed its staff to study the independent contractor/employee definitional problem. In the meantime, the Report noted,

"The Committee strongly urges the Internal Revenue Service not to issue retroactive Revenue Rulings in this area until after the completion of the staff study."

In a Senate floor exchange, Chairman Long of the Senate Finance Committee, and Senator Curtis (the ranking minority member) was at pains to make clear the committee's position that pending completion of this staff study, the IRS should not adopt retroactive changes in established employee classification rules, whether these took the form of published or private rulings, or simply of prior audit practice. Daily Cong. Rec., pp. S 12495–96 (July 26, 1976).

The Conference Committee joined the Senate Finance Committee in urging the IRS not to apply such changed positions retroactively, pending the staff study, which was to be made by the staff of the Joint Committee on Taxation. The conferees specifically endorsed the broad interpretation of this request, as spelled out in the Senate floor colloquy. Conf. Rept. on Tax Reform Act of 1976, H. Rept. 94–1515, p. 489 (Sept. 13, 1976).

Since 1976, however, Revenue Ruling 76–138 has not been withdrawn, and it is understood that the Service has pursued a vigorous audit program asserting huge back tax liabilities against many real estate brokers based on sales force structures that were believed to follow the *Dimmitt* pattern.

Thus, it is apparent that legislative relief is needed to assure that the traditional independent contractor/employee ground rules are not changed retroactively, with calamitous tax results for all who have relied on them.

POSITION OF SHANNON & LUCHS

Shannon & Luchs, in common with most real estate brokers, supports the continuation of traditional common law rules for determining who is an employee. The ability to classify real estate sales persons as independent contractors is typically desired by such sales persons because of the flexibility which it gives them to establish their own hours and methods of work. It is well known that the sale of real estate is a field offering perhaps a greator opportunit for part-time work than any other profesisonal activity in the country today. It allows a housewife, for example, to schedule her own hours and earnings in accordance with her needs, and it fosters ease of entry into the profession.

Such classification is equally important to brokers, in permitting them to maintain a sales force without a large fixed commitment in salaries and overhead.

In any case, Shannon & Luchs strongly opposes any IRS action to change these rules either on a case-by-case audit basis or through revenue rulings, because of

[1] S. Rept. 94–938, p. 604 (June 10, 1976).

the enormous uncertainty this could cause and the enormous potential tax liability. Clearly, any rules as long-established as these, and as important to thousands of people, should be changed only by deliberate legislative action, clearly defined, and with substantial advance notice to permit orderly compliance.

For these reasons, Shannon & Luchs strongly urges the enactment of legislation to require the Internal Revenue Service to follow its established rules for defining employees, unless and until these rules are changed by the Congress.

In this regard, we note that the House Ways & Means Committee has recently named a special seven-member Task Force to study the classification of individuals as employees or independent contractors for Federal tax purposes. Certainly, the need to await the recomendations of this study group is a further reason for deferring IRS action which would change long-standing practices by administrative action.

SPECIFIC BILLS

Specifically, we support S. 3007 and S. 3037, which are similar bills introduced by Senators DeConcini, Haskell and Dole, with the support of Senators Church, Curtis, Hatch, Lugar and Tower. These bills would require the Internal Revenue Service to follow pre–1976 rules in determining whether any individual is an employee for purposes of income tax withholding, social security taxes and unemployment taxes, unless and until further action of the Congress.

Surely, if long-established rules are to be changed, this should be done only by legislation, effective on a prospective basis, with ample advance notice so that the industry can restructure its practices on an orderly basis.

We urge you to give your support to this legislation.

Sincerely,

FOSTER SHANNON, *President.*

TREASURY DEPARTMENT'S RESPONSE TO SENATOR CURTIS (SEE PAGE 121)

The conferees on the Tax Reform Act of 1976 urged the Internal Revenue Service not to apply to past tax years any changed position or any newly stated position which is inconsistent with a prior general audit position in this area. The term "general audit position" has little or no meaning. Determinations as to whether workers are employees or independent contractors are made by applying the longstanding common law rules on a case-by-case basis, in accordance with the regulations and revenue rulings which were in effect before the Conference Report was issued. However, to the extent that it is possible to identify a "general audit position"—and hence to depart from such a position—such departures are initiated only by the National Office of the Internal Revenue Service. Therefore, it was not necessary for the National Office to instruct field offices not to make such departures.

APPENDIX

[COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS LISTED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON JULY 24, 1978

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JULY 21, 1978

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CONTENTS

I. INTRODUCTION

The 13 bills described in this pamphlet have been scheduled for a hearing on July 24, 1978, by the Subcommittee on Taxation and Debt Management of the Committee on Finance.

The pamphlet first briefly summarizes the bills, in the order in which the bills were listed in the press release announcing the hearings. This is followed by a discussion of each bill, setting forth present law, the issues involved, an explanation of what the bill would do, and the bill's effective date. The sponsor or sponsors of each bill are listed in the Table of Contents.

II. SUMMARY

1. S. 869

Small Issues Exception to Industrial Development Bond Tax Treatment

Under present law, the exemption from Federal income tax provided for interest on State and local government obligations generally does not apply to "industrial development bonds." However, an exception to the general rule of taxability of interest on industrial development bonds is provided for certain "small issues" of $1 million or less. At the election of the issuer, the $1 million limitation can be increased to $5 million if certain capital-expenditure conditions are satisfied.

The bill would increase the general dollar limitation in the "small issues" exception for industrial development bonds from $1 million to $10 million. The capital-expenditure condition, applicable under current law to the elective $5 million limitation, would be repealed.

2. S. 1674

Employer Recordkeeping and Reporting Duties Regarding Employee Tips

Present law requires an employee to report tips received to his or her employer, including tips added to a waiter's check by a charge customer and paid over to the waiter by the employer. The employer must report to the IRS (on Form W-2) both tips actually reported to the employer by the employee and, under IRS rulings issued in 1975 and 1976, any charge account tips not reported to the employer by the employee. In the Tax Reform Act of 1976, the Congress prohibited the IRS from following, prior to 1979, its 1975 and 1976 rulings on employer reporting of charge account tips.

The bill provides (1) that the only records which an employer would be required to keep in connection with charged tips would be charge receipts and copies of statements furnished by employees; (2) that the only tips the employer must report would be those reported to the employer by employees; and (3) that Forms W-2 filed by an employer would satisfy IRS information reporting requirements with respect to tip income of employees.

3. S. 2128

Credit for the Elderly

The bill would increase the initial credit base for the existing 15-percent credit for the elderly from $3,750 to $4,500 for married couples filing joint returns if both spouses are age 65 or over, and from $2,500 to $3,000 for single individuals age 65 or over and married couples if only one spouse is age 65 or over. In addition, the bill would provide for an annual inflation adjustment in the credit base. The bill also would eliminate the existing adjusted gross income phaseout of the credit base.

4. S. 2393

Treatment of Certain Liabilities on Incorporation of a Trade or Business

Under present law, no gain or loss generally is recognized for Federal income tax purposes if property is transferred to a corporation (usually upon its incorporation) solely in exchange for its stock or securities, and if the transferors control the corporation immediately after the exchange. However, gain is recognized to the extent that the sum of the amount of liabilities assumed by the corporation, plus the amount of liabilities to which the property is subject, exceeds the adjusted basis of the transferred property. A question has arisen under present law as to the treatment of certain currently deductible liabilities (such as trade accounts payable) if assumed by the corporation when property is so transferred by a taxpayer using the cash-basis accounting method.

The bill provides that in the case of cash-basis taxpayers transferring property to a controlled corporation, liabilities for currently deductible items (such as accounts payable for expenses) generally would not be considered "liabilities" for purposes of determining whether the transfer results in recognition of gain by the transferor.

5. S. 2462

Limited Individual Retirement Deduction for Plan Participants

Present law allows individuals a deduction from gross income for contributions to an individual retirement account (IRA), generally limited to the lesser of 15 percent of compensation or $1,500. However, an individual who is an active participant in a tax-qualified plan or in a governmental plan, or for whom amounts are contributed by the individual's employer to a tax-sheltered annuity, is not permitted to make a deductible contribution to an IRA for that year.

The bill would allow a deduction for contributions to an IRA in an amount equal to the difference between (1) the current-law dollar limitation on IRA contribution deductions and (2) the amounts contributed by or on behalf of the individual to a tax-qualified plan, to a governmental plan, or to a tax-sheltered annuity.

6. S. 3288

Deduction for Certain Employee Retirement Savings Contributions

Present law allows individuals a deduction from gross income for contributions to an individual retirement account (IRA), generally limited to the lesser of 15 percent of compensation or $1,500. However, an individual who is an active participant in a tax-qualified plan or a governmental plan, or for whom amounts are contributed by the individual's employer to a tax-sheltered annuity, is not permitted to make a deductible contribution to an IRA for that year. Also under present law, no deduction is allowed with respect to employee contributions to a tax-qualified plan, or to a group retirement trust maintained by a labor organization and funded exclusively by employee contributions.

The bill would allow a participant in a tax-qualified plan to deduct amounts contributed to an IRA, to the qualified plan, or both, up to a maximum aggregate deduction of $1,000 or 10 percent of compensation, whichever is less. Also, the bill would allow a participant in certain group retirement trusts to deduct contributions to the trust, to an IRA, or to both, up to certain maximum aggregate amounts.

7. S. 2628

Disability Income Exclusion for Married Taxpayers

Present law provides an exclusion from income tax for certain disability income. The exclusion is phased out if adjusted gross income (including disability income) exceeds $15,000. A married taxpayer must file a joint return to claim the exclusion unless both spouses lived apart for the entire year. The maximum exclusion is $100 a week ($5,200 a year).

The bill would repeal the joint-return requirement of present law. If the taxpayer files a separate return, the phase-out of the exclusion for adjusted gross income over $15,000 would be computed without regard to any income of the other spouse.

8. S. 2825

Public Charity Status of Certain Long-Term Care Organizations

Present law defines the term "private foundation" to mean any tax-exempt charitable, educational, religious, etc., organization *other than* certain specified categories of organizations. These categories ("public charities") include churches, schools, hospitals or certain medical research organizations, certain other organizations which receive specified "public" support, and organizations which are "supporting" organizations to other public charities. Public charities are not subject to the private foundation excise taxes; and, in general, the rules relating to income tax deductions by individuals for contributions to public charities or to private operating foundations are more favorable to the donor than the rules relating to the deductibility of contributions to private non-operating foundations.

The bill would exclude from private foundation status any tax-exempt charitable, etc., organization which, on or before May 26, 1969, and continuously thereafter to the close of the taxable year, operates and maintains as its principal functional purpose facilities for the long-term care, comfort, maintenance, or education of permanently and totally disabled persons, elderly persons, needy widows, or children.

9. S. 3007

Prohibition of Certain Employment Tax Status Reclassifications by the Internal Revenue Service

Under present law, the classification of workers as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes is made under common law rules as applied to the facts and circumstances of particular cases Generally, an employer must withhold Federal income taxes and the employee's share of social security taxes (FICA) from employee wages, and must pay the employer's share of social security tax (FICA) and the Federal unemployment tax (FUTA). Payments to independent contractors are subject to the tax on self-employment income (SECA) but generally are not subject to withholding.

The bill would prevent the Internal Revenue Service from applying any changed position or any newly stated position which is inconsistent with a general audit position in effect prior to January 1, 1976, or which is inconsistent with a regulation or ruling in effect on December 31, 1975, in determining whether an individual is an employee for purposes of FICA taxes, FUTA taxes, and Federal income tax withholding.

10. S. 3037

Employment Tax Status of Certain Real Estate Agents

Under present law, the classification of workers as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes is made under common law rules as applied to the facts and circumstances of particular cases. Generally, an employer must withhold Federal income taxes and the employee's share of social security taxes (FICA) from employee wages, and must pay the employer's share of social security tax (FICA) and the Federal unemployment tax (FUTA). Payments to independent contractors are subject to the tax on self-employment income (SECA) but generally are not subject to withholding.

In 1976, the Internal Revenue Service issued one ruling classifying certain real estate agents as independent contractors with respect to brokerage companies, and another ruling classifying certain real estate agents as employees of brokerage companies. A principal factor relied on in the second ruling for determining that the real estate agents were employees was a requirement of local law that the agent register his or her license in the name of the brokerage company.

The bill would require the employment tax status of real estate agents to be determined according to the rules in effect prior to the issuance of the two 1976 rulings, and without regard to any regulation, ruling, or decision issued on or after December 1, 1975, which reaches a result which is the same as or similar to the result of the two 1976 rulings.

11. S. 3080

Unemployment Tax Status of Certain Fishing Boat Services

Present law exempts from the Federal Insurance Contributions Act (FICA), and income tax withholding, services performed by fishing boat crew members if their remuneration is a share of the boat's catch or its proceeds or, in the case of an operation involving more than one boat, a share of the entire fleet's catch or its proceeds, and if the operating crew of such boat (or each boat in the fleet) normally is made up of fewer than 10 individual. However, those services which are exempt for purposes of FICA are not exempt for purposes of the Federal Unemployment Tax Act (FUTA) if the services are related to catching halibut or salmon for commercial purposes or if the services are performed on a vessel of more than 10 net tons.

The bill would exclude from coverage, for purposes of FUTA, those services of fishing boat crew members which currently are excluded for purposes of FICA and income tax withholding.

12. S. 3125

Involuntary Conversion of Special Use Valuation Property

Present law provides that, under certain circumstances, farm real property (or property used in a closely held business) can be valued for Federal estate tax purposes on the basis of its actual use rather than its highest and best use. However, the estate tax benefit of electing "special use valuation" is recaptured if the heir disposes of the property or changes its use within 15 years of the death of the decedent (or, if earlier, prior to the death of the heir). Under present law, this recapture rule applies to special use valuation property which is involuntarily converted (such as by condemnation) even if the proceeds of the condemnation are reinvested in property used for the same special use.

The bill generally provides that no recapture of the estate tax benefits would take place if the qualified property is involuntarily converted during the recapture period and the proceeds are fully reinvested in real property used for the same qualifying use. The bill also provides that proportionate recapture would occur in the case of a partial reinvestment of the involuntary conversion proceeds and that the basis of the involuntarily converted property would be stepped up in an amount equal to the recapture tax paid.

13. S. 3301

Basis of Player Contracts Acquired With Sports Franchise

The Tax Reform Act of 1976 added a requirement that, on acquisition of a sports franchise, the buyer must allocate the purchase price among the player contracts and other assets taking into account the seller's allocation of basis and gain among the assets. This provision was effective for sales or exchanges after December 31, 1975.

The bill would provide an exception with respect to a sale or exchange of a franchise before March 1, 1977 if, prior to December 31, 1975, the person who is the principal shareholder of the transferee at the time of the sale or exchange was committed to and did purchase more than 50 percent of the voting stock of the transferor.

III. DESCRIPTION OF BILLS

1. S. 869

Small Issues Exception to Industrial Development Bond Tax Treatment

Present law

Under present law (sec. 103(a) of the Code), interest on State and local government obligations generally is exempt from Federal income taxation. However, interest on State and local government issues of "industrial development bonds" is taxable, with certain exceptions (sec. 103(b)). A State or local government obligation is an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in a trade or business (unless carried on by a governmental unit or by certain tax-exempt organizations) and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property used in such trade or business.

An exception to the general rule of taxability of interest on industrial development bonds is provided for certain "small issues" (sec. 103(b)(6)). This exception applies to issues in amounts of $1 million or less, if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property. At the election of the issuer, the $1 million limitation can be increased to $5 million. If this election is made, the exception is restricted to projects where the capital expenditures and the total of a series of small issues over a six-year period do not exceed $5 million.

Both the $1 million and $5 million limitations are determined by aggregating the amounts of bond issues or capital expenditures for all facilities located within the same county or same incorporated municipality. However, facilities located in a county are not aggregated, for this purpose, with facilities located in incorporated municipalities within that county.

Issue

The issue is whether the general $1 million limitation in the exception granting income tax exemption to interest on "small issues" of industrial development bonds should be increased to $10 million.

Explanation of the bill

The bill would increase the general dollar limitation in the "small issues" exception for industrial development bonds from $1 million to $10 million. The capital-expenditure condition, applicable under current law to the elective $5 million limitation, would be repealed.

Effective date

The bill would apply to obligations issued after the date of enactment.

2. S. 1674

Employer Recordkeeping and Reporting Duties Regarding Employee Tips

Present law

Present law (sec. 6053(a) of the Code) requires an employee to report to his or her employer the tips received by the employee (if exceeding $20 in the month). The Internal Revenue Service has ruled that this reporting requirement applies with respect to both tips paid directly in cash by customers and also tips added to a waiter's check by a charge customer and paid over to the waiter by the employer (Rev. Rul. 75-400, 1975-2 C.B. 464, as modified by Rev. Rul. 76-231, 1976-1 C.B. 378). Under these rulings, the tips required to be so reported are tips received and retained after any tip-splitting, such as by waiters with busboys, or tip-pooling, such as by a waitress with other waitresses.

Section 6051(a) requires employers to report on IRS Forms W-2, as wages subject to income tax withholding and Federal Insurance Contributions Act (social security) withholding, only the tips actually reported to them by their employees pursuant to section 6053(a).[1] However, certain additional informational reporting is required of employers. Section 6041(a) requires every employer of an employee earning $600 or more yearly to report the total of that employee's earnings to the IRS. In interpreting this additional requirement, the regulations (sec. 1.6041-2(a)(1)) specify that any employee's earnings which are not required to be reported as subject to withholding nonetheless are required to be reported to the IRS by the employer; this additional income is to be reported separately on the Form W-2 for the employee. Thus in the case of tip income, the IRS has ruled (Rev. Ruls. 75-400 and 76-231, *supra*) that any charge account tips actually paid over by the employer to the employee must be reported to the IRS by the employer (assuming the aggregate $600 test is met) whether or not the tips were reported to the employer by the employee.[2]

Under the cited rulings, the IRS did not apply its new employer reporting requirements with respect to charge tips unreported by employees prior to 1977. The Congress, in section 2111 of the Tax Reform Act of 1976 (P.L. 94-455), provided that the IRS is not to

[1] If, because of tip-splitting or tip pooling, the amount of charge tips reported by an employee on his or her Federal income tax return differs from the amount of charge tips reported by the employer for that employee on Form W-2, the rulings permit the employee to attach an explanation of the difference to his or her income tax return.

[2] Under the facts of Rev. Rul. 76-231, *supra*, the employer received customer charge tickets from waiters and reviewed the tickets in order to determine the amounts payable to the employees as tips, thereby becoming aware of the amounts of such tips, whether or not later reported by the waiters to their employer.

follow Revenue Rulings 75-400 and 76-231 until 1979, and that, in the meantime, the IRS requirements with regard to reporting charge account tips are to be made in accordance with IRS practice prior to the issuance of those rulings.

Issues

The issues are whether employers should be required to report to the IRS charge account tips not reported to them by their employees and what records the employer must keep with respect to charge account tips.

Explanation of the bill

The bill provides (1) that the only records which an employer would be required to keep in connection with charged tips would be charge receipts and copies of statements furnished by employees under section 6053(a), and (2) that the only tips the employer must report would be those reported to the employers by their employees on statements furnished pursuant to section 6053(a). Statements filed by an employer (pursuant to sec. 6051(a)) transmitting this information to the IRS would constitute, and be in lieu of, any information return which might otherwise be considered required under section 6041(a).[3]

Effective date

The amendments made by the bill would apply to taxable years beginning after December 31, 1978.

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[3] Rev. Rul. 76-231, *supra*, states that section 6041(a) would require employers to report to the IRS charge account tips not reported to the employers by their employees.

3. S. 2128

Credit for the Elderly

Present law

In the case of individuals age 65 or over, present law provides a nonrefundable income tax credit equal to 15 percent of the credit base (sec. 37 of the Code). The initial credit base is $3,750 for married individuals filing joint returns if both are age 65 or over, and $2,500 for single individuals age 65 or over and married couples if only one spouse is age 65 or over. This initial base is reduced by amounts received as a pension or an annuity under the social security or railroad retirement systems, and also by one-half of adjusted gross income in excess of $10,000 for a married couple filing a joint return and $7,500 for a single individual. Thus, the credit is not available to married couples with adjusted gross incomes of $17,500 or greater if both spouses are age 65 or older ($15,000 if only one spouse is age 65 or over), or to single individuals with adjusted gross incomes of $12,500 or more.

Issues

The issues are whether the present levels of the credit for the elderly are appropriate, whether the amount of the credit should be adjusted automatically for inflation, and whether the credit should be phased out for persons above a certain adjusted gross income level.

Explanation of the bill

The bill would make three changes in the credit for the elderly. First, the bill would increase the initial credit base to $4,500 for married couples filing joint returns if both spouses are age 65 or over ($2,250 for those filing separate returns), and to $3,000 for single individuals age 65 or over and married couples if only one spouse is age 65 or over. Second, the credit base would be adjusted annually for inflation based on the annual increase in the consumer price index. Third, the bill would eliminate the adjusted gross income phaseout, with the result that elderly individuals at all levels of income would be eligible for the credit.

Effective date

The provisions would be effective for taxable years beginning after December 31, 1978.

4. S. 2393

Treatment of Certain Liabilities on Incorporation of a Trade or Business

Present law

Under present law, no gain or loss generally is recognized for Federal income tax purposes if property is transferred to a corporation (usually upon its incorporation) solely in exchange for its stock or securities, and if the transferors of such property control the corporation (i.e., own 80 percent or more of the stock) immediately after the exchange (sec. 351). However, gain is recognized to the extent that the sum of the amount of liabilities assumed by the corporation, plus the amount of liabilities to which the property is subject, exceeds the adjusted basis of the property transferred to the corporation (sec. 357(c)).[1]

A question has arisen under present law as to the treatment of certain liabilities (such as accounts payable) if assumed by the corporation when property is transferred, upon incorporation or in other generally tax-free asset-for-stock exchanges under section 351, by a taxpayer using the cash-basis accounting method.

Until recently, the United States Tax Court has given the term "liabilities" as used in section 357(c) an all-inclusive meaning.[2] Under this interpretation, a cash-basis taxpayer may be subject to recognition of gain upon incorporation of his or her trade or business. Thus, if the sum of the liabilities (including accounts payable) of a cash-basis taxpayer exceeds the basis of the taxpayer's assets, gain is recognized under section 357(c) even though there were neither tax benefits realized by the transferor on liabilities assumed by the corporation nor withdrawal of borrowed cash through loans made against assets transferred to the corporation prior to the transfer.

Three approaches have been developed by courts to alleviate this problem.

One alternative is that adopted by the Second Circuit in *Bongiovanni* v. *Comm'r*, 470 F.2d 921 (2d Cir. 1972), holding that the term "liability" for purposes of section 357(c) does not include accounts payable. The Second Circuit stated that:

> "Section 357(c) was meant to apply to what might be called 'tax liabilities', *i.e.*, liens in excess of tax costs, particularly mortgages encumbering property transferred in a Section 351 transaction. * * * The payables of a cash basis taxpayer are 'liabilities' for *accounting* purposes but should not be considered 'liabilities' for *tax* purposes under Section 357(c) until they are paid." 470 F. 2d at 924 (emphasis in original).

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[1] Section 357(c) also applies to reorganizations within the meaning of section 368(a)(1)(D).

[2] *Raich* v. *Comm'r*, 46 T.C. 604 (1966); *Thatcher* v. *Comm'r*, 61 T.C. 28 (1973), rev'd in part and aff'd in part, 533 F. 2d 1114 (9th Cir. 1976); *Bongiovanni* v. *Comm'r*, 30 CCH Tax Ct. Mem. 1124 (1971), rev'd, 470 F. 2d 921 (2d Cir. 1972).

The second judicial approach developed is that while no deductions are ordinarily available in section 351 exchanges, section 357(c) turns the transaction into an ordinary exchange for the purpose of recognizing gain. Since there is some authority for the proposition that in an ordinary exchange the assumption of liabilities by the purchaser will give the taxpayer an immediate deduction,[3] it was concluded that the transferor should receive a deduction for trade accounts payable discharged by the transferee in the same year as the transfer, to the extent of the accounts receivable or the gain recognized under section 357(c), whichever is less. This approach was suggested in a dissenting opinion by Judge Hall in the *Thatcher* case in the Tax Court, and was, in general, adopted by the Ninth Circuit in reversing the Tax Court's decision on this issue.[4] Under this approach, the deduction is allowed to the transferor only when the transferee corporation pays the assumed liability. Accordingly, it appears that under the Ninth Circuit's approach, the transferor could obtain a deduction on discharge of the transferred accounts payable in a year subsequent to the year of transfer.

Third, the Tax Court last year in the *Focht* case [5] reversed its longstanding position on the treatment of accounts payable under section 357(c). Under the Tax Court's approach, the term "liability" under section 357(c) would be limited to those obligations which, if transferred, cause gain recognition under *Crane* v. *Comm'r*, 331 U.S. 1 (1947), and an obligation would not be treated as a liability to the extent that its payment would have been deductible if made by the transferor. The Tax Court also held in *Focht* that under section 358, deductible liabilities are excluded in determining the transferor's basis in stock received as part of the exchange.

The Internal Revenue Service's position is that currently deductible liabilities (i.e., those which may be deducted by an accrual-basis taxpayer) consitute "liabilities" within the meaning of section 357(c). Rev. Rul. 69-442, 1969-2 C.B. 53.

Issues

The first issue is whether, for purposes of recognition of gain on transfers to a controlled corporation (sec. 357(c)), the term "liabilities" should exclude currently deductible liabilities (such as trade accounts payable) of a taxpayer on the cash-basis method of accounting.

Another issue is whether under section 358(d) such liabilities also should be excluded for purposes of determining the transferor's basis in stock received in certain transfers of property to a corporation if the corporation assumes or takes the property subject to the liabilities.

Explanation of the bill

Under the bill, in determining (for purposes of section 357(c)) the amount of liabilities assumed or to which the property transferred is subject, the amount of a liability would be excluded to the extent

[3] *James M. Pierce Corp.* v. *Comm'r*, 326 F.2d 67 (8th Cir. 1964).

[4] *Thatcher* v. *Comm'r*, 61 T.C. 28, 43 (1973) (Hall, J., dissenting), rev'd on this issue, 533 F.2d 114 (9th Cir. 1976).

[5] *Focht* v. *Comm'r*, 68 T.C. 223 (1977).

payment thereof by the transferor would have given rise to a deduction or would have constituted certa.n payments to partners under section 736(a).[6]

However, the amount of any liability excluded under this general rule would be included for purposes of the section 357(c) computation to the extent that the incurrence of such obligation resulted in the creation of, or an increase in, the basis of any property. This provision of the bill essentially would codify the approach taken by the Tax Court in the *Focht* case.

The bill further provides that in determining the transferor's basis in stock received in the exchange, liabilities excluded from the provisions of section 357(c) would not be treated as liabilities assumed or to which property is subject for purposes of section 358(d). This provision of the bill also would codify the approach taken by the Tax Court in *Focht.*

Effective date

The bill would apply to transfers of property to corporations made on or after the date of enactment.

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[6] Section 736(a) applies only to payments made to a retiring partner or to a deceased partner's successor in interest in liquidation of such partner's active interest in the partnership. If such payments meet the requirements of section 736, they are considered either as a distributive share of partnership income to the recipient or as guaranteed payments. If the payments are considered a distributive share of partnership income, then the distributive shares of the other partners are reduced. If payments are guaranteed payments, then they are deductible under section 162 by the partnership.

In either instance the obligation to make such payments is similar to the partnership's obligation with respect to its (deductible) accounts payable since both would constitute ordinary deductions or would reduce gross income to the nonretiring partners. Accordingly, under the bill, section 736(a) payments would be excluded in determining the amounts of liabilities assumed or to which the property transferred is subject for purposes of section 357(c) and 358(d).

5. S. 2462

Limited Individual Retirement Deduction for Plan Participants

Present law

Present law allows individuals a deduction from gross income for contributions to an individual retirement arrangement (an individual retirement account, an individual retirement annuity, or a retirement bond) (secs. 219, 220). The maximum deduction with respect to contributions for one year generally is the lesser of 15 percent of compensation includible in gross income or $1,500. In the case of an individual with a nonworking spouse, the maximum deduction is the lesser of 15 percent of compensation includible in gross income or $1,750, provided the individual shares the contribution equally with his or her spouse.

Under present law, no deduction is allowed with respect to a contribution to an individual retirement arrangement if for any part of the year the individual is an active participant in a tax-qualified retirement, bond purchase, or annuity plan or in a governmental plan, or if amounts were contributed by the individual's employer to a tax-sheltered annuity (secs. 219(b)(2), 220(b)(3)).

Issue

The issue is whether any deduction for contributions to an individual retirement arrangement should be allowed to an individual who during the year is an active participant in a tax-qualified plan or in a governmental plan, or for whom contributions are made by his or her employer to a tax-sheltered annuity.

Explanation of the bill

The bill would change present law in that an individual would no longer be prevented from making a deductible contribution to an individual retirement arrangement for a year for any part of which the individual is an active participant in a tax-qualified plan or a governmental plan or for which amounts were contributed by the individual's employer to a tax-sheltered annuity.

Under the bill, the maximum deduction allowable for a year for contributions to an individual retirement arrangement would be the present law limitation—the lesser of 15 percent of compensation or $1,500 ($1,750 in the case of a nonworking spouse sharing equally in the contribution)—reduced by the sum of any amounts contributed by or on behalf of the individual for the year to a tax-qualified plan, a governmental plan, or a tax-sheltered annuity.

The bill also provides that the plan administrator of a plan in which an individual is an active participant would be required to report to the participant, at his or her request, the amount of contributions made to the plan by or on behalf of the individual.

Effective date

The bill would apply to taxable years beginning after September 30, 1978.

6. S. 3288

Deduction for Certain Employee Retirement Savings Contributions

Present law

Present law allows individuals a deduction from gross income for contributions to an individual retirement arrangement (an individual retirement account, an individual retirement annuity, or a retirement bond) (secs. 219, 220). The maximum deduction with respect to contributions for one year generally is the lesser of 15 percent of compensation includible in gross income or $1,500. In the case of an individual with a nonworking spouse, the maximum deduction is the lesser of 15 percent of compensation includible in gross income or $1,750, provided the individual shares the contribution equally with his or her spouse.

Under present law, no deduction is allowed with respect to a contribution to an individual retirement arrangement if for any part of the year the individual is an active participant in a tax-qualified retirement, bond purchase, or annuity plan or in a governmental plan, or if amounts were contributed by the individual's employer to a tax-sheltered annuity (secs. 219(b)(2), 220(b)(3)).

In addition, under present law, no deduction is allowed with respect to employee contributions to a tax-qualified plan, or to a group retirement trust maintained by a labor organization described in sec. 501(c)(5) and funded exclusively by employee contributions.

Issues

The issues are (1) whether an individual who is an active participant in a tax-qualified plan during a year should be allowed any deduction for that year for a contribution to an individual retirement arrangement or to the tax-qualified plan, and (2) whether an individual should be allowed a deduction for contributions to a group retirement trust maintained by a labor organization and funded exclusively by employee contributions.

Explanation of the bill

The bill would change present law in that an individual who during the year is an active participant in a tax-qualified plan would no longer be prevented from making a deductible contribution for that year to an individual retirement arrangement or to the plan. Under the bill, the maximum aggregate deduction allowable to a plan participant for contributions to an individual retirement arrangement, for employee contributions to the qualified plan, or for both, would be the lesser of 10 percent of compensation includible in gross income or $1,000.

In addition, a participant in a group retirement trust established prior to January 1, 1974, maintained by a labor organization, and

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funded exclusively by employee contributions, would be eligible to deduct contributions to the trust. In the case of an individual who is not an active participant in a qualified plan, the maximum deduction would be the lesser of 15 percent of compensation includible in gross income or $1,500; in the case of an active participant in a qualified plan, the maximum deduction would be the lesser of 10 percent of compensation includible in gross income or $1,000. Any such deductible contributions to the trust would reduce, dollar for dollar, the deductible amount the individual could contribute to an individual retirement arrangement or to a qualified plan.[1]

Effective date

The bill would be effective for taxable years beginning after the date of its enactment.

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[1] Under the bill, an individual taking a deduction for a contribution to a tax-qualified plan or to a group retirement trust would not be permitted to take a deduction under the spousal individual retirement arrangement provisions for that year.

7. S. 2628

Disability Income Exclusion for Married Taxpayers

Present law

The Tax Reform Act of 1976 (P.L. 94–455, sec. 505) repealed the "sick pay" exclusion and replaced it with a more limited exclusion from gross income for certain disability income, effective for taxable years beginning after December 31, 1975 (sec. 105 of the Code). This effective date was postponed by the Tax Reduction and Simplification Act of 1977 (P.L. 95–30, sec. 301) to taxable years beginning after December 31, 1976.

As a general rule, the exclusion is available only for taxpayers under age 65 who have retired on disability, at a time when they were permanently and totally disabled. The maximum exclusion is $100 a week ($5,200 a year).

The amount excludable is reduced on a dollar-for-dollar basis by the taxpayer's adjusted gross income (including disability income) in excess of $15,000. Thus, if a taxpayer receives $5,200 in disability income and $15,000 (or more) in other income, together equalling $20,200 (or more), he or she would not be entitled to any exclusion of disability payments.[1]

In order to claim this exclusion, a taxpayer who is married at the close of a taxable year must file a joint return with his or her spouse, unless they have lived apart at all times during that year.

Issue

The issue is whether a married taxpayer who has not lived apart from his or her spouse at all times during the taxable year should be permitted to claim the disability income exclusion even though he or she files a separate return.

Explanation of the bill

The bill would repeal the requirement of present law that to claim the disability income exclusion, a married taxpayer who has not lived apart from his or her spouse for the entire taxable year must file a joint return. If the taxpayer filed a separate return, the phase-out of the exclusion for adjusted gross income over $15,000 would be computed under the bill without regard to any income of the other spouse.

Effective date

The bill would apply to taxable years beginning after December 31, 1976.

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[1] H.R. 6715, the Technical Corrections Act of 1978, as reported by the Senate Finance Committee, would clarify present law by providing that each spouse is entitled to a separate, maximum $5,200 exclusion, but the phaseout for adjusted gross income in excess of $15,000 would apply on a per-return basis.

8. S. 2825

Public Charity Status of Certain Long-Term Care Organizations

Present law

Section 509(a) of the Code defines the term "private foundation" to mean any charitable, educational, religious, or other organization described in section 501(c)(3), *other than* certain specified categories of organizations. These categories (known as "public charities") include churches, schools, hospitals or certain medical research organizations, certain other organizations which receive specified "public" support, and organizations which are "supporting" organizations to other public charities. For this purpose, under Treasury regulations, the term "hospital" does not include "convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purpose or function is to train handicapped individuals to pursue some vocation" (Reg. sec. 1.170A–9(c)(1)).

A private foundation is subject to an annual 4-percent excise tax on its net investment income (sec. 4940).[1] In addition, a private foundation generally is subject to excise taxes if it fails to comply with requirements to make annual expenditures or distributions for exempt purposes equal to specified amounts or if it violates prohibitions against acquiring or holding "excess" business interests, against making investments deemed to jeopardize its exempt purposes, or against making certain "taxable expenditures" (secs. 4942–4945). Also, any violation of the prohibition against direct or indirect "self-dealing" transactions involving a private foundation results in imposition of excise taxes on the participating "self-dealer" (sec. 4941).

In general, the rules relating to income tax deductions by individuals for contributions to public charities or to private operating foundations[2] are more favorable to the donor than the rules relating to the deductibility of contributions to private non-operating foundations (sec. 170). For example, gifts of cash to public charities or private operating foundations are deductible up to 50 percent of the taxpayer's adjusted gross income in the year of contribution, with a five-year carryforward of any excess; gifts of cash to private non-operating foundations generally are deductible up to 20 percent of adjusted gross income, with no carryforward available. Also, a donor giving long-term capital gain property to a public charity or private operating foundation generally can deduct the property's fair market value, up to 30 per-

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[1] H.R. 112, as reported by the Senate Finance Committee on May 9, 1978, would reduce the tax to 2 percent for taxable years beginning after September 30, 1977.

[2] A private foundation may qualify as an "operating" foundation if it spends directly for the active conduct of its exempt-purpose activities amounts which are at least equal to 85 percent of its adjusted net income, and which are at least equal to $3\frac{1}{3}$ percent of its net endowment assets, or if the foundation meets certain other tests (sec. 4942(j)(3)).

cent of the individual's adjusted gross income, with a five-year carryforward of any excess. If long-term capital gain property is donated to a private non-operating foundation, the deductible amount generally equals fair market value less 50 percent of the gain which would be recognized if the property were sold; also, the deduction (as so reduced) cannot exceed 20 percent of the donor's adjusted gross income, with no carryforward of any excess available.

Issue

The issue is whether the categories of section 501(c)(3) organizations excluded from private foundation status should be expanded to include those organizations which maintain facilities for the long-term care, comfort, maintenance, or education of disabled or elderly persons, needy widows, or children, and which do not qualify as public charities under present law (e.g., as publicly supported organizations).

Explanation of the bill

The bill would exclude from private foundation status an organization, described in section 501(c)(3), which, on or before May 26, 1969, and continuously thereafter to the close of the taxable year, operates and maintains as its principal functional purpose facilities for the long-term care, comfort, maintenance, or education of permanently and totally disabled persons, elderly persons, needy widows, or children. As a result, such a long-term care organization would not be subject to the annual excise tax imposed on the net investment income of private foundations or to other private foundation excise taxes, and the "public charity" rules with respect to charitable contribution deductions would apply to persons making contributions to such organizations.

It is understood that the bill would benefit the Sand Springs Home in Oklahoma and approximately 26 other identified homes around the country. Any other long-term care organization meeting the requirements of the bill (such as continuous operation since May 26, 1969 of qualifying long-term care facilities) also would be treated under the bill as a public charity.

Effective date

The bill would apply retroactively to January 1, 1970.

9. S. 3007

Prohibition of Certain Employment Tax Status Reclassifications by the Internal Revenue Service

Present law

With certain limited statutory exceptions, the classification of particular workers or classes of workers as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes is made under common law rules. A determination of an employer-employee relationship is important because a certain amount of wages paid to employees generally is subject to social security taxes imposed on the employer and employee under the Federal Insurance Contributions Act (FICA) [1] and the Federal Unemployment Tax Act (FUTA) [2]. On the other hand, payments to independent contractors are subject to the tax on self-employment income (SECA).[3] In addition, Federal income tax must be withheld from compensation paid to employees, but payments to independent contractors are not subject to withholding (except for certain payments to nonresident aliens).

For calendar year 1978, both employers and employees must pay FICA taxes amounting to 6.05 percent each on the first $17,700 of an employee's wages. Both the FICA tax rate and the wage base are scheduled to increase in later years. The FUTA tax is levied on employers at a rate of 3.4 percent currently on wages up to $6,000 paid to each employee. However, a 2.7 percent credit against Federal tax liability is provided to employers who pay State taxes under an approved State unemployment compensation program. Since all States have an approved unemployment compensation program, the effective FUTA tax rate i· ↄ.7 percent.

Self-employed individuals with annual self-employment earnings in excess of $400 must pay a tax of 8.10 percent on self-employment earnings up to $17,700 for calendar year 1978.

The following table shows the maximum employment taxes for calendar 1978:

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[1] Secs. 3101 and 3111 of the Code.
[2] Sec. 3301.
[3] Sec. 1401.

Maximum Employment Taxes

[Calendar 1978]

Tax	Status of worker	
	Employee	Independent contractor
FICA:		
Employer share	$1,070.85	
Employee share	1,070.85	
FUTA	204.00	
Self-employment		$1,433.70
Total taxes	2,345.70	1,433.70

Generally, the basis for determining whether a particular worker is an employee or independent contractor is the common law test of control. Under Treasury regulations, if a person engaging the services of another has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is accomplished," the relationship of employer and employee is deemed to exist (Treas. Reg. sec. 31.3401(c)–1(b)). On the other hand, the absence of a right to control generally indicates that the person performing the services is an independent contractor. The Treasury regulations set forth twenty factors to be used in determining whether workers are employees or independent contractors.

Although the Internal Revenue Service has published revenue rulings on the classification of some workers, most status determinations by the IRS depend on the facts and circumstances of the particular work relationships and thus are made on a case-by-case basis in the course of taxpayer audits.

During the conference on the Tax Reform Act of 1976, House and Senate conferees included in the conference Statement of Managers a request that the IRS "not apply any changed position or any newly stated position in this general subject area to past, as opposed to future taxable years" until the completion of a study by the staff of the Joint Committee on Taxation on the problems of classifying persons as employees or independent contractors (H. Rept. No. 94–1515, 94th Cong., 2d Sess., p. 489). In response to this request, the IRS has been suspending, prior to assessment, certain employment status cases which were initiated after the 1976 Act or which had not reached the assessment stage when that legislation was enacted (October 4, 1976), provided the taxpayer waives the statute of limitations for the suspension period.

Issue

The issue is whether, pending general legislation in this area, the Internal Revenue Service, under general audit positions, regulations, rulings, or decisions which are inconsistent with positions, regulations, rulings, or decisions in effect before 1976, should be allowed to reclassify as employees for Federal employment tax purposes workers treated by a taxpayer as independent contractors.

Explanation of the bill

The bill would prevent the Internal Revenue Service from applying any changed position or any newly stated position which is inconsistent with a general audit position in effect prior to January 1, 1976, or which is inconsistent with a regulation or ruling in effect on December 31, 1975, in determining whether an individual is an employee for purposes of FICA taxes, FUTA taxes, and Federal income tax withholding. This restriction on IRS action would remain in effect until the Congress amends the Internal Revenue Code definition of employee.

Effective date

The bill would apply to changes in general audit positions taken and regulations and rulings issued after December 31, 1975, in the area of employment status classifications.

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10. S. 3037

Employment Tax Status of Certain Real Estate Agents

Present law

With certain limited statutory exceptions, the classification of particular workers or classes of workers as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes is made under common law rules. A determination of an employer-employee relationship is important because a certain amount of wages paid to employees generally is subject to social security taxes imposed on the employer and employee under the Federal Insurance Contributions Act (FICA) [1] and the Federal Unemployment Tax Act (FUTA).[2] On the other hand, payments to independent contractors are subject to the tax on self-employment income (SECA).[3] In addition, Federal income tax must be withheld from compensation paid to employees, but payments to independent contractors are not subject to withholding (except for certain payments to nonresident aliens).

For calendar year 1978, both employers and employees must pay FICA taxes amounting to 6.05 percent each on the first $17,700 of an employee's wages. Both the FICA tax rate and the wage base are scheduled to increase in later years. The FUTA tax is levied on employers at a rate of 3.4 percent currently on wages up to $6,000 paid to each employee. However, a 2.7 percent credit against Federal tax liability is provided to employers who pay State taxes under an approved State unemployment compensation program. Since all States have an approved unemployment compensation program, the effective FUTA tax rate is 0.7 percent.

Self-employed individuals with annual self-employment earnings in excess of $400 must pay a tax of 8.10 percent on self-employment earnings up to $17,700 for calendar year 1978.

The following table shows the maximum employment taxes for calendar 1978:

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[1] Secs. 3101 and 3111 of the Code.
[2] Sec. 3301.
[3] Sec. 1401.

Maximum Employment Taxes

[Calendar 1978]

Tax	Status of worker: Employee	Status of worker: Independent contractor
FICA:		
Employer share	$1,070.85	
Employee share	1,070.85	
FUTA	204.00	
Self-employment		$1,433.70
Total taxes	2,345.70	1,433.70

Generally, the basis for determining whether a particular worker is an employee or independent contractor is the common law test of control. Under Treasury regulations, if a person engaging the services of another has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which the result is accomplished," the relationship of employer and employee is deemed to exist (Treas. Reg. sec. 31.3401(c)-1(b)). On the other hand, the absence of a right to control generally indicates that the person performing the services is an independent contractor. The Treasury regulations set forth twenty factors to be used in determining whether workers are employees or independent contractors.

Although the Internal Revenue Service has published revenue rulings on the classification of some workers, most status determinations by the IRS depend on the facts and circumstances of the particular work relationships and thus are made on a case-by-case basis in the course of taxpayer audits.

In 1976, the IRS published two revenue rulings on the classification of real estate agents for Federal tax purposes. Revenue Ruling 76-136 [1] basically restated and thereby superseded an earlier IRS position published in Mimeograph 6566,[2] which held that certain real estate agents performing services for brokerage companies were independent contractors. The IRS had issued Mimeograph 6566 in 1951 after a decision by the Eighth Circuit Court of Appeals [3] had reversed a prior Treasury position [4] to the effect that real estate agents who perform services for brokers generally were employees of the brokers for employment tax purposes.

[1] 1976-1 C.B. 312.
[2] 1951-1 C.B. 108.
[3] *Dimmitt-Rickoff-Boyer Real Estate Co. v. Finnegan*, 179 F.2d 882 (8th Cir.), cert. den., 340 U.S. 823 (1950).
[4] Mim. 5504, 1943 C.B. 1066.

However, Revenue Ruling 76-137,[5] the second ruling published in 1976 on the status of real estate agents, classified some of them as employees, notwithstanding the apparent factual similarities to the circumstances covered in Rev. Rul. 76-136. In Rev. Rul. 76-137, the IRS reasoned in part that because the salespeople were required by local regulation to have their licenses registered in the name of the brokerage company, the salespeople should be treated as employees. The IRS stated that the facts in Rev. Rul. 76-137 were distinguishable from those in Rev. Rul. 76-136 and in the 1951 decision of the Eighth Circuit.[6]

During the conference on the Tax Reform Act of 1976, House and Senate conferees included in the conference Statement of Managers a request that the IRS "not apply any changed position or any newly stated position in this general subject area to past, as opposed to future taxable years" until the completion of a study by the staff of the Joint Committee on Taxation on the problems of classifying persons as employees or independent contractors (H. Rpt. No. 94-1515, 94th Cong., 2d Sess., p. 489). In response to this request, the IRS has been suspending, prior to assessment, certain employment status cases which were initiated after the 1976 Act or which had not reached the assessment stage when that legislation was enacted (October 4, 1976), provided the taxpayer waives the statute of limitations for the suspension period.

Issue

The issue is whether, pending general legislation in this area, the Internal Revenue Service should classify certain real estate agents as independent contractors or as employees for Federal employment tax purposes in accordance with rules in effect before issuance of the 1976 rulings and without regard to regulations, rulings, and decisions issued on or after December 1, 1975.

Explanation of the bill

The bill would require the Internal Revenue Service to determine the status of real estate salespeople under the rules, including Treasury Mimeograph 6566, which were in effect before the issuance of Revenue Rulings 76-136 and 76-137, and without regard to the two 1976 rulings or any regulation, decision, or ruling issued on or after December 1, 1975, which reaches a result identical or similar to the result of the two 1976 rulings.

The bill would become permanent law. However, maintenance of the pre-1976 status quo would be intended to afford the Congress an opportunity to consider legislation after completion of the study provided under the Conference Report on the Tax Reform Act of 1976.

Effective date

The bill would apply to regulations, rulings, and decisions issued on or after December 1, 1975.

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[5] 1976-1 C.B. 313.
[6] Note 3, *supra*.

11. S. 3080

Unemployment Tax Status of Certain Fishing Boat Services

Present law

Under present law (sec. 3121(b)(20) of the Code), members of the crew on boats engaged in catching fish or other forms of aquatic animal life are treated as self-employed for purposes of the Federal Insurance Contributions Act (FICA) if their remuneration is a share of the boat's catch or of the proceeds of the catch, or, in the case of an operation involving more than one boat, a share of the entire fleet's catch or its proceeds, and if the operating crew of such boat (or each boat in the fleet) normally is made up of fewer than ten individuals.

Further, the remuneration received by those crew members who are treated as self-employed for FICA purposes is not considered to be "wages" for purposes of income tax withholding (sec. 3401(a)(17)), and those individuals are considered to be self-employed for purposes of the Self-Employment Contributions Act (sec. 1402(c)(2)(F)). However, the employer of such individuals whose services are exempt for FICA purposes is not exempt from tax under the Federal Unemployment Tax Act (FUTA) if the services performed by the crew are related to catching halibut or salmon for commercial purposes or the services are performed on a vessel of more than ten net tons (sec. 3306(c)(17)).

Issue

The issue is whether the services of fishing boat crew members which currently are exempt for purposes of FICA also should be exempt for purposes of FUTA.

Explanation of the bill

The bill would exempt for purposes of FUTA the services of fishing boat crew members which currently are exempt for purposes of FICA. Thus, the crew on boats engaged in catching fish or other forms of aquatic animal life would be treated as self-employed for FUTA purposes, as well as for purposes of FICA and income tax withholding, if their remuneration is a share of the boat's catch or of the proceeds of the catch, or, in the case of an operation involving more than one boat, a share of the entire fleet's catch or its proceeds, and if the operating crew of such boat (or each boat in the fleet) normally is made up of fewer than ten individuals.

Effective date

The bill would apply to services performed by fishing boat crew members after December 31, 1977.

12. S. 3125

Involuntary Conversion of Special Use Valuation Property

Present law

Under present law, an executor can elect to value, for Federal estate tax purposes, certain real property used as a farm for farming purposes or in a closely held trade or business according to the value for its actual use ("special use valuation"), rather than at its fair market value determined on the basis of highest and best use (sec. 2032A of the Code).

To assure that the property as to which such an election has been made continues to be used for farming or for other closely held business uses, a recapture rule is provided (sec. 2032A(c)). In general, this rule results in recapture of the estate tax benefit of the special valuation if the heir disposes of the property or changes its use within 15 years of the death of the decedent (or, if earlier, prior to the death of the heir). The purpose of this recapture rule is to prevent the heir from having the property valued for a special use for estate tax purposes, but then obtaining a higher value by sale or change of use.

Under present law, this recapture rule applies to special use valuation property which is involuntarily converted (such as by condemnation) even if the proceeds of the condemnation are reinvested in property used for the same special use.

Present law also provides that the basis of "carryover basis property" generally is adjusted by the amount of Federal and State estate and inheritance taxes attributable to appreciation (sec. 1023(c)). Although the purpose of the recapture tax is generally to place the estate (and the heir) in essentially the same position as if special use valuation had not been elected, no adjustment is provided under current law for any portion of the recapture tax imposed upon the disposition of special use valuation property.

Issues

The issues are generally as follows: (1) whether the recapture tax should be imposed on the involuntary conversion of special use valuation property if replacement property is acquired within a reasonable period of time and (2) whether, in situations where the recapture tax is imposed by reason of an involuntary conversion, such tax (or a portion thereof) should be added to the heir's basis in the property for income tax purposes.

Explanation of the bill

The bill would provide that if an involuntary conversion of qualified real property takes place, no recapture of the estate tax benefit would occur if the property is replaced by other real property of at least equal value to be used for the same use. If qualified real property is replaced by property of lesser value, the recapture would apply only in the proportion that the excess of the amount realized in the conversion over the amount reinvested bears to the amount realized on the conversion. These rules generally would give the taxpayer the same time to make a qualified replacement as under the present income tax involuntary conversion rules--i.e., two years from the date of the conversion.

The bill also provides that if qualified real property which is subject to an involuntary conversion is carryover basis property, its basis would be increased for income tax purposes in an amount equal to the recapture tax imposed.[1] This adjustment would be treated as having been made immediately before the property was involuntarily converted; thus, the adjustment would result in a reduction in the amount of gain (or an increase in the amount of loss) realized on the involuntary conversion. If the involuntarily converted property is replaced by property of at least equal value to be used for the same use, no recapture tax would be imposed and hence no basis adjustment would be made.

Effective date

The bill would apply to involuntary conversions after December 31, 1976 (the effective date of the estate tax changes for special use property made by the Tax Reform Act of 1976).

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[1] Under present law (sec. 1023(c)), the basis of carryover basis property is adjusted with respect to Federal and State estate and inheritance taxes only to the extent attributable to the appreciation element of the property. Thus, if an executor does not elect "special use" valuation, the property's basis will be increased by the portion of the estate tax attributable to appreciation. By comparison, the bill would increase the basis of certain involuntarily converted "special use" realty by the full amount of the recapture tax, rather than only by the amount of the recapture tax attributable to appreciation.

13. S. 3301

Basis of Player Contracts Acquired With Sports Franchise

Present law

Prior to the Tax Reform Act of 1976, there was no specific rule relating to the allocation of a portion of the total consideration paid to acquire a sports franchise, including depreciable player contracts and other assets, such as nondepreciable franchise rights, which might be acquired at the time of acquisition of a franchise. Generally, this allocation was made on the basis of the estimated fair market values (or relative fair market values) of the various assets.

The 1976 Act added a provision (sec. 1056 of the Code) providing that, in the case of the sale, exchange, or other disposition of a sports franchise (or the creation of a new franchise), the amount of consideration allocated to a player contract by the transferee is not to exceed the sum of the adjusted basis of the contract in the hands of the transferor immediately before the transfer and the gain (if any) recognized by the transferor on the transfer of the player contract.

Present law also provides that, in the case of the sale or exchange of a sports franchise, it is presumed that not more than 50 percent of the consideration is allocable to player contracts unless the taxpayer can satisfy the IRS that under the facts and circumstances of the particular case, it is proper to allocate an amount in excess of 50 percent.

In general, the purpose of these provisions added by the 1976 Act was to prevent unreasonable allocations of an aggregate purchase price for a sports franchise between depreciable and nondepreciable assets.

The provisions relating to the allocation of basis to player contracts apply to sales or exchanges of franchises after December 31, 1975, in taxable years ending after that date.

Issue

The issue is whether the basis allocation limitation rules should apply to a sale or exchange of a sports franchise before March 1, 1977 if, prior to December 31, 1975, the person who is the principal shareholder of the transferee at the time of the sale or exchange was committed to and did purchase more than 50 percent of the voting stock of the transferor.

Explanation of the bill

The bill would make the basis allocation limitation rules inapplicable to a sale or exchange of a sports franchise before March 1, 1977 if, prior to December 31, 1975, the person who is the principal shareholder of the transferee at the time of the sale or exchange was committed to and did purchase more than 50 percent of the voting stock of the transferor.

The amendment would benefit Mr. William H. Sullivan, Jr., and the New England Patriots Football Club, Inc.

Effective date

The bill would apply to certain sales or exchanges of a sports franchise after December 31, 1975, and before March 1, 1977.

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