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FEDERAL UNEMPLOYMENT TAX IN CASE OF INSURANCE AGENTS REMUNERATED SOLELY BY COMMISSIONS; WITHHOLDING OF CITY INCOME TAXES ON FEDERAL EMPLOYEES; DEDUCTION OF PORTION OF STATE TAX ON MOTOR VEHICLES WHERE GENERAL SALES TAX RATE IS LESS

OCTOBER 14, 1972.—Ordered to be printed

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

REPORT

[To accompany H.R. 7577]

The Committee on Finance, to which was referred the bill (H.R. 7577) to amend section 3306 of the Internal Revenue Code of 1954, having considered the same, reports favorably thereon with amendments and recommends that the bill, as amended, do pass.

I. SUMMARY

The purpose of H.R. 7577, as passed by the House, is to provide that the exclusion from the definition of the term "employment" under the Federal Unemployment Tax Act of the services of insurance agents and solicitors who are compensated on a commission basis will be applied on a calendar quarter basis rather than an annual basis or an individual pay period basis. The committee has accepted this House-passed provision.

The committee has also added two amendments to the bill. The first amendment relates to withholding, for purposes of the income tax imposed by certain cities, on the compensation of Federal employees. Present law (5 U.S.C. 5517) provides that where State laws require the withholding by employers of a tax from the compensation of employees, the Federal Government where certain conditions are met is, upon request, to enter into an agreement to withhold the State tax from compensation paid Federal employees who are employed in the State. This provision amends this statute to provide also for the withholding of city taxes by the Federal Government under certain conditions with respect to its employees who are employed in a city with such a tax if the city has a population of 60,000 or more.

The second amendment relates to the deduction of a portion of a State tax on motor vehicles in the case where that tax rate is higher

than the general sales tax rate. Under present law, State taxes on motor vehicles are deductible where that tax is at the same rate as (or at a lower rate than) the State's general sales tax. However, where the State tax on motor vehicles is imposed at a higher rate than the general sales tax rate, the entire tax is nondeductible. The Committee amendment permits a deduction of the portion of the taxes on motor vehicles which is equal to the general tax rate.

II. FEDERAL UNEMPLOYMENT TAX IN CASE OF INSURANCE AGENTS REMUNERATED SOLELY BY COMMISSIONS

Section 3306(c)(14) of the Internal Revenue Code of 1954 excepts from the meaning of the term "employment," for the purposes of the Federal Unemployment Tax Act, "service performed by an individual for a person as an insurance agent or as an insurance solicitor, if all such service performed by such individual for such person is performed solely by way of commission."

In Revenue ruling 67–44 (CB 1967–1, 287) the Internal Revenue Service applied the exception of insurance agents and solicitors from the definition of employment under section 3306(c)(14) only in instances where all of the remuneration paid to an insurance agent or solicitor throughout the entire calendar year was remuneration solely by way of commission.

Under the ruling, in any case in which any other type of remuneration, in cash or in kind, is paid by an employer to an insurance agent or solicitor at any time during the calendar year, the employer is liable for the tax with respect to all of the remuneration paid to the employee during the entire calendar year, including all remuneration by way of commission. For example, if an employer conducts a training program and pays its agents a salary while participating in such program, all of the earnings an agent receives from the employer during the year including commissions, is subject to the Federal Unemployment Tax Act.

Prior to the enactment of Public Law 91–53 in 1969, Federal unemployment tax liability was accrued with respect to remuneration paid during a calendar year and the taxes with respect to remuneration for employment in the entire calendar year became due and payable on January 31 of the following calendar year.

The exception contained in section 3306(c)(14), and the implementing IRS ruling, created no administrative or collection problems with respect to the Federal tax when the Federal tax was collected on an annual basis. Prior to the enactment of Public Law 91–53, when reports and tax payments were made in January, the type of remuneration paid to insurance agents and solicitors during the previous calendar year was known and accuracy of reporting and payment were assured.

Under the existing quarterly collection system and the Service's interpretation of the insurance salesmen exception, tax liability created by the unforeseen payment of remuneration to insurance salesmen on a basis other than a commission basis late in a calendar year may affect the validity and accuracy of tax payments and reports completed

in good faith for earlier calendar quarters, and may require, in addition to procedures for identifying the incidence of such cases, new computations and correcting adjustments in later reports.

Section 3306(d) of the Code provides that where an employee performs taxable services and also exempt services during a pay period, then the employee's total services for that pay period will be treated as being exempt if more than half of those services are exempt. From this, it has been argued that present law contemplates that coverage or exemption is to be determined on a pay-period-by-pay-period basis. As applied to the insurance salesmen provision, this means that a salary payment or year-end bonus in one pay period would result in taxation only of that period's compensation, not taxation of the entire year's compensation.

This provision is intended to resolve that controversy for the future; no inference is intended as to the application of this exemption for the past.

This provision of the bill would adapt the current provision dealing with the treatment of the employment and remuneration of insurance agents and solicitors who are paid on a commission basis to the new quarterly tax collection provisions of Public Law 91–53. The amendment provided by the bill would have the effect of exempting from the Federal unemployment tax all commission income if that were the only type of remuneration paid by an employer in a calendar quarter, even though remuneration other than commission income was paid to the employee in some other calendar quarter of the calendar year. For example, if an employee was remunerated solely by way of commission in the first 3 quarters of a calendar year but was transferred to a salaried job or was paid a Christmas bonus in the fourth quarter, the Federal unemployment tax would be payable with respect to fourth quarter remuneration but not with respect to the first 3 quarters. At the same time, it is made clear that a salary payment in one pay period will result in the commissions for the entire calendar quarter becoming subject to the unemployment tax.

Whether there is a gain or a loss of Federal tax revenue depends upon how present law is interpreted and could be expected to be inconsequential in amount. The amendment could also be expected to have a negligible effect upon coverage under State unemployment insurance laws.

III. WITHHOLDING OF CITY INCOME TAXES ON FEDERAL EMPLOYEES

In 1952, in the report on the bill which led to withholding by the Federal Government of State taxes collected through withholding (H.R. 5157, 82d Cong., 2d sess., although action was taken on S. 1999 which became Public Law 587, 82d Cong., 2d sess.), it was pointed out that at that time Federal agencies lacked the authority to withhold State income taxes from the salaries of Federal employees. In that report it was urged that provision be made for withholding of these income taxes with respect to Federal employees in view of the cooperation of the State governments with the Federal Government in withholding Federal income taxes from State employees. The committee

believes that the same reasons require the Federal Government to withhold city income taxes from Federal employees. The cities also have cooperated in withholding Federal income taxes for compensation paid city employees. In addition, it appears desirable to treat the Federal employees, for purposes of these city taxes, in the same manner as private employees.

As a result, this provision of the bill provides for withholding by the Federal Government in the case of incorporated cities with populations of 60,000 or more (according to the last decennial census before the city's request for withholding is made). This restriction is imposed in order to limit the administrative burden being assumed by the Federal Government. Where taxes are imposed by smaller municipalities, the number of Federal employees involved is likely to be few, with the result that the Federal Government, if it were to withhold in such cases, would be required to set up withholding procedures for taxes involving relatively few Federal employees.

It is important to note that there are a number of restrictions in existing law, now applicable to State withholding taxes, which under the bill will also apply to the city withholding taxes. These are designed both to limit the administrative burdens of the Federal Government and to prevent hardship and discrimination in the case of the Federal employees involved. These restrictions can be summarized as follows:

(1) The law of the State or city must impose the duty of withholding upon employers generally. Thus, Federal employees cannot be singled out for this purpose.

(2) The law of the State or municipality must impose the duty of withholding generally with respect to compensation of employees who are residents of the State or city. Thus, the Federal Government will not be required to withhold taxes on Federal employees where the State or city requires withholding only with respect to nonresidents.

(3) The Federal Government is authorized to enter into agreements for the withholding of State or city taxes only in the case of employees whose regular place of Federal employment is within the boundaries of the State or city imposing the tax. Thus, for example, withholding will not apply in the case of an individual merely because the office paying his salary is located in the State or city imposing the tax.

(4) No Federal withholding of State or city tax is to apply with respect to compensation for services as a member of the Armed Forces (since such service at any location may be of a transient character).

(5) The Federal Government will not consent to the application of any provision of a city's law which has the effect of imposing more burdensome requirements upon the United States than it imposes upon other employers, or which has the effect of subjecting the United States or any of its officers or employees to any penalties or liability as a result of this law.

This provision merely provides a method of collecting, by withholding, municipal income taxes already imposed on Federal Government employees. Issues such as the jurisdiction of a city to tax any employee

or group of employees still will be matters to be settled by the appropriate courts unaffected by the fact that the Federal Government has withheld tax. The term "city statute" (as used in sec. 5517) means a city law or ordinance of general application.

The committee has been informed that municipal taxes which provide for withholding on compensation presently are in effect in nine States: Alabama,[1] [2] Delaware, Kentucky,[1] Maryland, Michigan, Missouri, New York, Ohio, and Pennsylvania. In these States there are 41 cities which according to the 1960 census had populations of 60,000 or more which levy municipal income taxes which are withheld by employers.[3] The income tax rates imposed by these cities vary from one-fourth of 1 percent to 3 percent. The cities referred to are:

Delaware: Wilmington.

Kentucky: [1] Covington, Lexington, and Louisville.

Maryland: Baltimore.

Michigan: Detroit, Flint, Grand Rapids, Lansing, Pontiac, and Saginaw.

Missouri: Kansas City and St. Louis.

New York: New York City.

Ohio: Akron, Canton, Cincinnati, Cleveland, Cleveland Heights, Columbus, Dayton, Euclid, Hamilton, Lakewood, Lorain, Parma, Springfield, Toledo, and Youngstown.

Pennsylvania: Allentown, Altoona, Bethlehem, Chester, Erie, Harrisburg, Lancaster, Philadelphia, Pittsburgh, Reading, Scranton, and Wilkes-Barre.

As in the case of withholding of State income taxes at the present time, the United States, under the bill, will not accept compensation for services rendered in withholding the city income taxes.

This provision shall apply only with respect to agreements entered into after the date of enactment of this bill.

IV. Deduction of Portion of State Tax on Motor Vehicles Where General Sales Tax Rate Is Less

Present law enumerates the classes of taxes that are allowable as deductions for Federal income tax purposes. The term "general sales tax" is defined (in sec. 164(b)(2)(A)) as a tax imposed at retail at one general rate on a broad range of classes of items. However, a lower rate of tax than the general rate may apply to food, clothing, medical supplies, or motor vehicles.

The reason for generally requiring the same rate of tax over a wide range of items was because Congress was attempting to allow deductions for "general sales taxes," as distinct from "selected excise taxes." It is recognized, however, that in the case of general sales taxes, exemptions or lower taxes frequently were allowed for food, clothing, medical supplies, and motor vehicles. The first three items often are taxed at a lower rate or exempted in order to reduce the impact of the sales tax on lower income groups. Motor vehicles often are taxed at a

[1] The taxes imposed in Alabama and Kentucky are termed occupational license taxes.
[2] Alabama has no cities over 60,000 in population imposing income taxes.
[3] No attempt has been made here to determine whether or not all of the cities referred to meet the qualifications of this bill.

lower rate or exempted because separate taxes are frequently imposed on them.

It has come to the committee's attention that in some States sales taxes have been imposed on motor vehicles at rates which are higher than the general sales tax rate. This presently is true in West Virginia and Vermont. In the case of West Virginia, the general sales tax is imposed at a rate of 3 percent. Prior to April of 1971, the West Virginia tax on motor vehicles was imposed at 3 percent and since this was at the same rate as the State's general sales tax it was considered to be part of the general sales tax. In April of 1971, however, the State increased its tax on motor vehicles to 5 percent. Since this is at a rate higher than the general rate of tax, the tax is now not deductible since it no longer is treated as a part of the general sales tax. A similar problem exists in the State of Vermont.

The committee decided that in the case of taxes on motor vehicles it was appropriate to treat them as a part of the general sales tax, and therefore permit a deduction of the portion of the taxes on motor vehicles which is comparable to the general sales tax rate. As a result, the provision specifies that if the rate of tax on motor vehicles exceeds the general sales tax rate, the excess is disregarded and, insofar as the deduction provision is concerned, the general sales tax rate is treated as the rate of tax on motor vehicles. This means, for example, that in the case of the 5 percent motor vehicle tax in West Virginia, 3 percentage points of the tax would be treated, in effect, as part of the general sales tax and would be deductible. The remaining 2 percentage points tax is not to be deductible.

This amendment applies to taxable years ending on or after January 1, 1971.

V. EFFECT ON THE REVENUES OF THE BILL

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the effect on the revenues of the bill. The committee estimates that the provision of the bill dealing with the Federal unemployment tax in case of insurance agents remunerated solely by commissions will have an inconsequential effect on Federal unemployment tax revenue. The provision of the bill dealing with the withholding of city income tax on Federal employees will have no effect on the revenues. The provision of the bill dealing with the deductibility of a portion of a State tax on motor vehicles where the general sales tax rate is less is estimated to result in a decrease in Federal individual income tax liability for calendar year 1972 of about $1.5 million. The Department of Treasury agrees with this statement.

VI. CHANGES IN EXISTING LAW

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

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