1981-82 MISCELLANEOUS TAX BILLS VI

HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 230, S. 450, S. 644, S. 978, and S. 1039

MAY 22, 1981

Printed for the use of the Committee on Finance

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1981-82 MISCELLANEOUS TAX BILLS VI

FRIDAY, MAY 22, 1981

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. Bob Packwood (chairman of the subcommittee) presiding.

Present: Senators Packwood and Matsunaga.

[The press releases announcing the hearing, the bills S. 230, S. 450, S. 644, S. 978, and S. 1039, the Joint Committee on Taxation description and the prepared statement of Senator Robert J. Dole follow:]

[Press release, May 1, 1981]

SENATOR BOB PACKWOOD, CHAIRMAN OF THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE SENATE COMMITTEE ON FINANCE ANNOUNCED TODAY THAT THE SUBCOMMITTEE WILL HOLD A HEARING ON MONDAY, MAY 18, 1981

The hearing will begin at 9:30 a.m. on May 18, 1981, in Room 2221, of the Dirksen Senate Office Building.

The following legislative proposals will be considered at the hearing:

S. 230—Introduced by Senator Matsunaga. Would permit withholding of State income tax from certain seamen's wages on a voluntary basis.

S. 644—Introduced by Senator Jepsen. Would liberalize certain personal holding company provisions as applied to consumer finance companies.

S. 978—Introduced by Senators Danforth and Chiles. Would permit an employer to provide W-2 forms for terminated employees at year-end, rather than at the time of termination.

S. 979—Introduced by Senators Lugar and Quayle. Would provide that interest on obligations of certain volunteer fire departments be exempt.

S. 1039—Introduced by Senator Packwood. Would make permanent the exclusion from gross income of the value of employer contributions to or services provided by a qualified group legal services plan.

Requests to testify.—Witnesses who desire to testify at the hearing on May 18, 1981 must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than noon on Monday, May 11, 1981. Witnesses will be notified as soon as practicable thereafter whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such case a witness should notify the Committee of his inability to appear as soon as possible.

Consolidated testimony.—Senator Packwood urges all witnesses who have a common position or who have the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Packwood urges very strongly that all witnesses exert a maximum effort to consolidate and coordinate their statements.

Legislative Reorganization Act.—Senator Packwood 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 should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(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 100 copies must be submitted by noon on Friday, May 15, 1981.

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

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

Written statements.—Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record on the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, not later than Monday, June 1, 1981.

[Press release, May 13, 1981]

Senator Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance Announced Today That the Subcommittee's Hearing Scheduled for Monday, May 18, 1981 Has Been Postponed

The hearing has been rescheduled to begin at 9:30 a.m. on Friday, May 22, 1981, in Room 5110 of the Dirksen Senate Office Building.

Senator Packwood also announced that S. 979 will not be considered at the rescheduled hearing but will be considered at a later Subcommittee hearing. S. 979 would provide that interest on obligations of certain volunteer fire departments be exempt.

In addition to S. 230, S. 644, S. 978 and S. 1039, described in the original May 1 announcement of the Subcommittee hearing, the following legislative proposal will be considered at the rescheduled hearing:

S. 450—(Senators Matsunaga, Boren, Ford, and Huddleston) Would provide that the investment tax credit apply to the acquisition of work and breeding horses to the extent that the cost of such horses does not exceed $100,000 for a taxable year.

Requests to Testify.—Witnesses who have already submitted requests to testify at the May 18 hearing need not submit an additional request to testify. Other witnesses who desire to testify at the hearing on May 22, 1981 must submit a written request to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, to be received no later than noon on Monday, May 18, 1981. Witnesses will be notified as soon as practicable whether it has been possible to schedule them to present oral testimony. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance. In such case a witness should notify the Committee of his inability to appear as soon as possible.

Consolidated Testimony.—Senator Packwood urges all witnesses who have a common position or who have the same general interests to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views than it might otherwise obtain. Senator Packwood urges very strongly that all witnesses exert a maximum effort to consolidate and coordinate their statements.

Legislative Reorganization Act.—Senator Packwood 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 arguments."

Witnesses scheduled to testify should comply with the following rules:

(1) All witnesses must submit written statements of their testimony.

(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 *100 copies* must be submitted by noon on the last business day preceding the witness's scheduled appearance.

(4) Witnesses should not read their written statements to the Subcommittee, but ought instead to confine their oral presentations to a summary of the points included in the statement.

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

Written statements. Witnesses who are not scheduled to make an oral presentation, and others who desire to present their views to the Subcommittee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearings. These written statements should be typewritten, not more than 25 double-spaced pages in length, and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510, not later than Friday, June 5, 1981. On the first page of your written statement please indicate the date and subject of the hearing.

II

97TH CONGRESS
1ST SESSION

S. 230

To authorize certain withholding of State income tax from seamen's wages on a voluntary basis.

IN THE SENATE OF THE UNITED STATES

JANUARY 22 (legislative day, JANUARY 5), 1981

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

---

A BILL

To authorize certain withholding of State income tax from seamen's wages on a voluntary basis.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SECTION 1. That section 12 of the Act of March 4,
4 1915 (38 Stat. 1169; 46 U.S.C. 601), is amended by insert-
5 ing before the period at the end thereof a comma and the
6 following: "but nothing in this section shall prohibit any such
7 withholding of the wages of any such seaman, who is em-
8 ployed in the coastwise trade between ports in the same

1 State, pursuant to a voluntary agreement between such
2 seaman and his employer".

3 SEC. 2. This amendment shall become effective on the
4 date of this Act's enactment.

II

97TH CONGRESS
1ST SESSION

S. 450

To amend the Internal Revenue Code of 1954 to provide that the investment tax credit shall apply to the acquisition of work and breeding horses to the extent that the cost of such horses does not exceed $100,000 for the taxable year.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 6 (legislative day, JANUARY 5), 1981

Mr. MATSUNAGA (for himself, Mr. BOREN, Mr. FORD, and Mr. HUDDLESTON) 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 provide that the investment tax credit shall apply to the acquisition of work and breeding horses to the extent that the cost of such horses does not exceed $100,000 for the taxable year.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) subsection (a) of section 48 of the Internal Revenue
4 Code of 1954 (defining section 38 property) is amended by
5 adding at the end thereof the following new paragraph:
6 "(11) WORK AND BREEDING HORSES.—

1 "(A) IN GENERAL.—Work and breeding
2 horses shall be treated as livestock to which para-
3 graph (6) applies.

4 "(B) OVERALL AND PER HORSE DOLLAR
5 LIMITATION.—The cost which may be taken into
6 account under section 46(c)(1) of horses treated as
7 section 38 property by reason of subparagraph (A)
8 for any taxable year shall not exceed $100,000:
9 *Provided,* That in the case of any one horse—

10 "(i) acquired by a partnership, the cost
11 taken into account by the partnership with
12 respect to such horse shall not exceed
13 $100,000, or

14 "(ii) acquired by more than one tax-
15 payer under circumstances where the provi-
16 sions of subchapter K are not applicable, the
17 aggregate cost taken into account by all such
18 taxpayers with respect to such horse shall
19 not exceed $100,000.

20 "(C) SPECIAL RULES.—Rules similar to the
21 rules of paragraph (2) of subsection (c) (including
22 the application of subsection (c)(3) thereto) shall
23 apply for purposes of this paragraph.".

1 (b)(1) The first sentence of paragraph (6) of section 48(a)
2 of such Code is amended by striking out "(other than
3 horses)".

4 (2) The last sentence of such paragraph (6) is amended
5 to read as follows: "Except as provided in paragraph (11),
6 horses shall not be treated as livestock for purposes of the
7 preceding sentence and shall not be treated as section 38
8 property.".

9 (c) The amendments made by this Act shall apply to
10 taxable years beginning after the date of enactment.

O

II

97TH CONGRESS
1ST SESSION

S. 644

To amend the Internal Revenue Code of 1954 with respect to the treatment of certain lending or finance businesses for purposes of the tax on personal holding companies.

IN THE SENATE OF THE UNITED STATES

MARCH 6 (legislative day, FEBRUARY 16), 1981

Mr. JEPSEN 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 the treatment of certain lending or finance businesses for purposes of the tax on personal holding companies.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) clause (ii) of section 542(c)(6)(C) of the Internal Rev-
4 enue Code of 1954 (relating to exceptions from definition of
5 personal holding company) is amended by striking out "but
6 not $1,000,000".
7 (b) Clause (i) of section 542(d)(1)(B) of such Code is
8 amended to read as follows:

1 "(i) making loans, or purchasing or dis-
2 counting accounts receivable, notes, or in-
3 stallment obligations, if (at the time of the
4 loan, purchase, or discount) the remaining
5 maturity exceeds 144 months; unless—
6 "(I) the loans, notes, or installment
7 obligations are evidenced or secured by
8 contracts of conditional sale, chattel
9 mortgages, or chattel lease agreements
10 arising out of the sale of goods or serv-
11 ices in the course of the borrower's or
12 transferor's trade or business, or
13 "(II) the loans, advances, or in-
14 stallment obligations are made or ac-
15 quired by the taxpayer and meet the re-
16 quirements of subparagraph (C).".
17 (c) Paragraph (1) of section 542(d) of such Code is
18 amended by adding at the end thereof the following new sub-
19 paragraph:
20 "(C) INDEFINITE MATURITY CREDIT TRANS-
21 ACTIONS.—For purposes of subparagraph (B)(i), a
22 loan, advance, or installment obligation meets the
23 requirements of this subparagraph if it is made
24 under an agreement—

1 "(i) under which the creditor agrees to
2 make loans or advances (not in excess of an
3 agreed upon maximum amount) from time to
4 time to or for the account of the debtor upon
5 request, and
6 "(ii) under which the debtor may repay
7 the loan, advance, or installment obligation
8 in full or in installments.".
9 (d) The amendments made by this section shall apply to
10 taxable years beginning on or after December 31, 1980.

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II

97TH CONGRESS
1ST SESSION

S. 978

To amend the Internal Revenue Code of 1954 to modify certain W-2 filing requirements.

IN THE SENATE OF THE UNITED STATES

APRIL 9 (legislative day, FEBRUARY 16), 1981

Mr. DANFORTH (for himself and Mr. CHILES) 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 modify certain W-2 filing requirements.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SECTION 1. Subsection (a) of section 6051 of the Inter-
4 nal Revenue Code of 1954 (relating to receipts for employ-
5 ees) is amended by striking out "on the day on which the last
6 payment of remuneration is made" and inserting in lieu
7 thereof "within 30 days after receipt of a written request
8 from the employee if earlier than such January 31".

1 SEC. 2. The amendments made by this Act shall apply
2 with respect to employees whose employment is terminated
3 after the date of enactment.

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II

97TH CONGRESS
1ST SESSION

S. 1039

To make the exclusion of amounts received under a qualified group legal services plan permanent, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 29 (legislative day, APRIL 27), 1981

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

---

A BILL

To make the exclusion of amounts received under a qualified group legal services plan permanent, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 EXCLUSION PERMANENT
4 Paragraph (1) of section 2134(e) of the Tax Reform Act
5 of 1976 (relating to the effective date) is amended by striking
6 out ", and ending before January 1, 1982".

O

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on May 22, 1981, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are five bills scheduled for the hearing: S. 230 (relating to withholding of State income tax from seamen's wages on a voluntary basis), S. 450 (allowance of investment tax credit for work and breeding horses), S. 644 (treatment of certain finance companies as personal holding companies), S. 978 (modification of certain Form W-2 filing requirements), and S. 1039 (permanent extension of provisions for qualified group legal services plans).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, an explanation of the bills, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 230—SENATOR MATSUNAGA; WITHHOLDING OF STATE INCOME TAX FROM SEAMEN'S WAGES ON A VOLUNTARY BASIS

Under present law, employers must deduct and withhold Federal income and social security taxes from wages paid to employees (Code secs. 3402 and 3102). In general, employers are permitted (and may be required by State law) to deduct and withhold State income taxes. However, present law prohibits withholding of State taxes from wages of a seaman or fisherman (46 U.S. Code sec. 601), in order to prevent more than one State from requiring withholding in the case of a seaman or fisherman employed on a vessel operating between ports of more than one State. It is not clear under present law whether this prohibition extends to withholding that is voluntary as well as to that which is mandated by State income tax laws.

The bill would provide that a seaman or fisherman employed in the coastwise trade between ports of the same State may, after the date of enactment of the bill, enter into a voluntary agreement with employers for withholding from wages of amounts as State income taxes.

2. S. 450—SENATORS MATSUNAGA, BOREN, FORD, AND HUDDLESTON

Under present law, the ten-percent investment tax credit is available for livestock, other than horses, which is used in a trade or business or for income production and which has a useful life of three years or more (Code sec. 48(a)(6)).

The bill would provide that horses held for working and breeding purposes (but not horses held for racing or show purposes) would be eligible, if otherwise qualifying, for the investment tax credit. The bill would llimit to $100,000 the cost of horses that could be considered by a taxpayer in claiming an investment tax credit for any year. In the case of multiple taxpayers or partnerships acquiring one horse, the total cost taken into consideration by all of the owners or the partnership could not exceed $100,000.

The provisions of the bill would apply in the case of horses acquired in taxable years beginning after the date of enactment of the bill.

3. S. 644—SENATOR JEPSEN; TREATMENT OF CERTAIN FINANCE COMPANIES AS PERSONAL HOLDING COMPANIES

Under present law, a tax is imposed on the undistributed personal holding company income of a personal holding company (Code sec. 541). Generally, personal holding company income includes interest. A corporation actively engaged in a lending or finance business is exempt from this tax if the corporation has qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from its lending or finance business, plus five percent of such ordinary gross income from $500,000 to $1 million. The term "lending or finance business" is defined to include the business of making loans with maturities of no more than 60 months.

The bill would increase the 60-month limitation of present law to 144 months, and would amend the definition of a lending or finance business to include the business of making certain types of revolving credit loans. The bill also would amend the business expense test of present law to require a lending or finance business to have qualifying business expenses equal to 15 percent of the first $500,000 of ordinary gross income from the lending or finance business, plus five percent of such ordinary gross income in excess of $500,000. Thus the $1 million ordinary gross income

amount would be eliminated for purposes of applying the qualifying business expense test.

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

4. S. 978—SENATORS DANFORTH AND CHILES; MODIFICATION OF CERTAIN FORM W-2 FILING REQUIREMENTS

Present law requires an employer which pays wages from which Federal income tax or FICA (social security) tax must be withheld to furnish each employee a statement listing, among other information, the amount of income tax and FICA wages paid and the amounts withheld as tax (Form W-2). Except in the case of certain employees whose employment terminates during the year, Form W-2 must be supplied to the employee not later than January 31 of the year following the year in which the wages are paid. In the case of an employee whose employment terminates before the end of the calendar year, Form W-2 must be supplied to the employee with the final payment of wages (Code sec. 6051(a)).

Under the bill, the employer of an employee whose employment terminates during the year would be required to furnish the employee with a Form W-2 no later than January 31 of the following year (the same time all other employees must be provided a W-2), unless the employee requests an early receipt. If a terminating employee makes a written request for early receipt of a Form W-2, the employer would be required to furnish the W-2 no later than 30 days after the written request is received (rather than with the last payment of wages).

The provisions of the bill would apply in the case of employees whose employment terminates after enactment of the bill.

5. S. 1039—SENATOR PACKWOOD; PERMANENT EXTENSION OF PROVISIONS FOR QUALIFIED GROUP LEGAL SERVICES PLANS

Under present law (Code sec. 120), effective for 1977 through 1981, employer contributions to a qualified group legal services plan and the benefits provided to an employee under the plan are excluded from the employee's income. The employer generally is allowed a business expense deduction for contributions to the plan.

The bill would make permanent the provisions of present law relating to a qualified group legal services plan. The bill would be effective on enactment.

II. DESCRIPTION OF BILLS

1. S. 230—SENATOR MATSUNAGA; WITHHOLDING OF STATE INCOME TAX FROM SEAMEN'S WAGES ON A VOLUNTARY BASIS

Present law

Under present law, employers must deduct and withhold Federal income and social security taxes from wages paid to employees (Code secs. 3402 and 3102.)[1] In general, employers are permitted (and may be required by State law) to deduct and withhold State income taxes. However, present law prohibits withholding from wages of a seaman or fisherman any amounts for taxes imposed by a State, including a territory, possession, commonwealth, or a subdivision thereof (46 U.S. Code sec. 601).

This prohibition prevents several States from requiring withholding on the wages of a seaman or fisherman, as could happen if the vessel on which the seaman or fisherman is employed regularly operates between ports in those States. The prohibition also applies in the case of seamen and fishermen employed on vessels operating exclusively between ports of the same State. It is not clear under present law whether this prohibition extends to withholding that is voluntary as well as to that which is mandated by State income tax laws.

Issue

The issue is whether seamen and fishermen should be permitted to enter into voluntary agreements with their employers for withholding of State income tax from their wages, and if so, whether this rule should apply only to seamen and fishermen employed on vessels operating between ports in the same State.

---

[1] Wages paid to fishermen for services performed on a boat are not subject to withholding of Federal income or social security taxes if (1) the fishermen receive shares of the catch, the amounts of which are contingent on the boat's catch, and (2) the operating crew of each boat from which an individual receives a share normally consists of fewer than ten individuals (Code secs. 3401(a)(17) and 3121(b)(20)).

Explanation of the bill

The bill would provide that a seaman or fisherman employed in the coastwise trade between ports of the same State may enter into a voluntary agreement with employers for withholding from wages of amounts as State income taxes.

Effective date

The bill would permit seamen and fishermen to enter, after the date of enactment of the bill, into voluntary withholding agreements with employers for State income taxes.

Revenue effect

The bill would not have any effect on Federal budget receipts.

2. S. 450—SENATORS MATSUNAGA, BOREN, FORD, AND HUDDLESTON; ALLOWANCE OF INVESTMENT TAX CREDIT FOR WORK AND BREEDING HORSES

Present law

When the investment tax credit was restored in 1971, the credit was made applicable to livestock other than horses (Code sec. 48(a)(6)). To be eligible for credit, livestock must be used in a trade or business or for the production of income (i.e., be subject to depreciation) and have a useful life of three years or more. The exclusion of horses applies not only to horses used for sporting purposes (such as race horses and show horses), but also to horses held for working and breeding purposes.

Issue

The issue is whether horses held for working and breeding purposes should be eligible for the investment tax credit.

Explanation of the bill

Under the bill, horses held for working and breeding purposes (but not for racing or show purposes) would be eligible for the investment tax credit if otherwise meeting the requirements for the credit. The bill would limit to $100,000 the cost of horses that could be considered by a taxpayer in claiming an investment tax credit for any year. In the case of multiple taxpayers or partnerships acquiring one horse, the total cost taken into consideration by all of the owners or the partnership could not exceed $100,000.

Effective date

The provisions of the bill would apply in the case of horses acquired in taxable years beginning after the date of enactment of the bill.

Revenue effect

It is estimated that the bill would reduce budget receipts by $8 million in fiscal year 1982, $21 million in 1983, $23 million in 1984, $25 million in 1985, and $28 million in 1986.

Prior Congressional action

The Revenue Act of 1978, as reported by the Committee on Finance, included a provision similar to the present bill (S. Rep. 95-1263, 95th Cong.). That provision was deleted by the conference committee.

3. S. 644—SENATOR JEPSEN; TREATMENT OF CERTAIN FINANCE COMPANIES AS PERSONAL HOLDING COMPANIES

Present Law

In general. Code section 541 imposes a 70-percent tax on the undistributed personal holding company income of a personal holding company. This provision is intended to prevent individuals from avoiding the graduated individual tax rates (up to 70 percent under present law) by holding investments through corporations, which are subject to a maximum tax rate of 46 percent.

A corporation constitutes a personal holding company if 60 percent on its adjusted gross income is personal holding company income and if 50 percent of its stock is owned by five or fewer shareholders at any time during the last half of the taxable year. Personal holding company income generally is defined as interest, divideds, royalties, rents, and certain other types of passive investment income.

Exclusion for lending, finance companies. Certain types of corporations actively engaged in a trade or business which produces income that usually would be considered passive investment income are excluded from the personal holding company tax provisions. Among the corporations excluded from these provisions are lending or finance companies.

A corporation qualifies as a lending or finance company if 60 percent of its ordinary gross income is derived from the active and regular conduct of a lending or finance business and certain other requirements are satisfied. The term "lending or finance business" is defined, in part to mean a business of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, which at the date of the loan or acquisition have a remaining maturity of no more than 60 months. An exception to the 60-month rule is provided for loans, notes, or obligations secured by a security interest in personal property where the security interest arose out of the sale of goods or services in the course of the borrower's or transferor's trade or business.

The personal holding company provisions also apply a business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business. Under this requirement, a corporation does not qualify as a lending or finance company exempt from the personal holding company provisions unless the sum of its business expenses directly allocable to its lending or finance business equals or exceeds 15 percent of the first $500,000 of its ordinary gross income derived from a lending or finance business plus five percent of such ordinary gross income from $500,000 to $1 million.

Issues

The issues are whether to broaden the exclusion from personal holding company status for lending or finance businesses to include the business of making revolving credit loans or loans with maximum maturities of 144 months, and whether to modify the business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business.

Explanation of the bill

The bill would modify both the 60-month maturity limitation and the business expense requirement of the lending or finance company exception to the personal holding company provisions.

Under the bill, the definition of a lending or finance business would be broadened to include the business of making loans with maturities up to 144 months and to include the business of making certain types of revolving credit loans. Revolving credit loans qualifying under the bill would be such loans made under an agreement which provides that, the creditor will make loans or advances (not in excess of an agreed upon maximum amount) from time to time for the account of the debtor upon request and which provides that the debtor may repay the loan, advance, or installment obligation in full or in installments.

The bill also would modify the amount of business expenses required in determining whether a corporation with more than $1 million in ordinary gross income from a lending or finance business is a lending or finance company. Under the bill, a corporation would satisfy the business expense test only if its qualifying business expenses equal or exceed 15 percent of the first $500,000 of ordinary gross income derived from a lending or finance business, plus five percent of such ordinary gross income in excess of $500,000.

Effective date

The provisions of the bill would apply to taxable years beginning on or after December 31, 1980.

Revenue effect

It is estimated that the bill would reduce budget receipts by less than $5 million annually.

Prior Congressional action

A similar provision was included in H.R. 7171 (96th Congress) as reportd by the Finance Committee (Sen. Rep. 96-1032) and passed by the Senate on December 13, 1980. That provision was deleted by the House in agreeing to H.R. 7171 on December 13, 1980.

4. S. 978—SENATORS DANFORTH AND CHILES; MODIFICATION OF CERTAIN FORM W-2 FILING REQUIREMENTS

Present law

Under present law, an employer which pays wages from which Federal income tax or FICA (social security) tax must be withheld is required to furnish each employee a statement which sets forth the names of the employer and employee, the amount of wages subject to income tax withholding and the amount withheld, the amount of FICA wages and the FICA tax withheld, and the amount of any

advance payments of the earned income credit (Code sec. 6051(a)). A copy of this statement must be filed with the Internal Revenue Service (sec. 6051(d)).

Form W-2, prescribed by the Internal Revenue Service, is used by employers to satisfy this requirement. The W-2 statement is used by the employee in preparing the individual income tax return, and a copy of the statement is attached to that return when filed.

The statement of earnings must be supplied to the employee not later than January 31 of the calendar year following the year in which the wages are paid. In the case of an employee whose employment terminates before the end of the calendar year, present law requires that the statement be supplied to the employee with the final payment of wages (Code sec. 6051(a)).

Under Treasury regulations (Reg. § 31.6051-1(d)(1)), an employer may furnish Form W-2 to an employee whose employment terminates prior to the close of the calendar year at any time after the termination but no later than January 31 of the following year. However, if an employee whose employment terminates prior to the close of the calendar year requests earlier receipt of a Form W-2, and if there is no reasonable expectation on the part of the employer and employee of further employment during the calendar year, then the regulations provide that the employee must be given a Form W-2 on or before the later of the 30th day after the request or the 30th day after the last salary payment. It is no clear whether there is a statutory basis for this approach in the regulations.

Issue

The issue is when an employer should be required to furnish Form W-2 to a terminating employee.

Explanation of the bill

Under the bill, an employer would be permitted to defer furnishing the required statement of earnings to an employee whose employment terminates until not than January 31 of the calendar year following the year in which the last wages are paid. If the employee makes a writen request for earlier receipt of the statement, the bill would require the employer to furnish the statement within 30 days of the request.

Effective date

The provisions of the bill would apply in the case of employees whose employment terminates after the date of enactment of the bill.

Revenue effect

The bill would not have any effect on budget receipts.

Prior Congressional action

In the 96th Congress, the Senate Finance Committee reported a bill (H.R. 5829, sec. 225) which included provisions relating to deferral of furnishing W-2 statements to terminated employees (Sen. Rept. 96-940). That bill also would have required the employer to provide written notice to a terminating employee of the requirement for earlier furnishing of the statement on written request from the employee. No further action was taken on H.R. 5829.

Earlier in the 96th Congress, the Finance Subcommittee on Taxation and Debt Management held a hearing on another bill (S. 2171), which contained provisions identical in substance to section 225 of H.R. 5829. No further action was taken on S. 2171.

5. S. 1039—SENATOR PACKWOOD; PERMANENT EXTENSION OF PROVISIONS FOR QUALIFIED GROUP LEGAL SERVICES PLANS

Present law

Income exclusion.—Under present law (Code sec. 120), employer contributions to a qualified group legal services plan and benefits provided under the plan to an employee (or the employee's spouse or dependents) are excluded from the participant's income. This income exclusion for qualified group legal services plans is scheduled to expire on December 31, 1981.

Requirements for qualified plans.—A qualified group legal services plan must be a separate written plan of an employer for the exclusive beneift of employees,[1] their spouses, or their dependents.[2] The plan must provide participants with specified benefits consisting of personal (i.e., nonbusiness) legal sevices by prepaying or pro-

[1] A sole proprietor or partner is considered to be an employee of the proprietorship or partnership and therefore is eligible for plan benefits.

[2] For this purpose, a dependent is a person who qualifies as such for purposes of the dependency exemption (Code sec. 152).

viding in advance for all or a part of the participant's legal fees. Plan benefits may consist of legal services provided directly to a participant or cash payments from the plan that are made to or on behalf of the participant to cover the cost of legal services. Direct reimbursement by the employer to the employee is not permitted.

In order to be a qualified plan, a group legal services plan must also meet requirements with respect to nondiscrimination in contributions or benefits and in eligibility for enrollment. The contributions paid by an employer and the benefits provides under a plan may not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. The plan must benefit employees who qualify under a classification which the employer sets up and which the Internal Revenue Service determines does not discriminate in favor of such employees. In determining whether the classification is discriminatory, the employer may exclude from the calculations those employees who are covered by a collective bargaining agreement (as determined by the Secretary of Labor) if there is evidence that group legal services plan benefits were the subject of good faith bargaining between representatives of that group and the employer.

Contribution limitation. The qualification rules limit amounts that may be contributed under a qualified group legal services plan for employees who own more than five percent of the stock in the employer corporation or more than five percent of the capital or profits interest in an unincorporated trade or business. For any plan year, the aggregate of the contributions for those employees (and their spouses and dependents) must not be more than 25 percent of the total contributions. Constructive ownership rules apply for determining stock ownership or an ownership interest in an unincorporated trade or business.

Restrictions on payments of employer contributions. Amounts contributed by employers under a qualified group legal services plan may be paid only (1) to insurance companies or to organizations or persons that provide personal legal services or indemnification against the cost of personal legal services, in exchange for a prepayment or a payment of a premium; (2) to a tax-exempt organization which forms part of a qualified group legal services plan (Code sec. 501(c)(20)); (3) to a tax-exempt organization which is permfitted to receive contributions for a qualified group legal services plan (e.g., a voluntary employees' beneficiary assocition described in Code sec. 501(c)(9)), provided thatthe organization then pays or credits the contributions to a tax-exempt organization that forms a part of the qualified group legal services plan; (4) as prepayments to providers of legal services under the plan; or (5) to a combination of the four permissible types of payment arrangements.

Deduction for employer contributions. Employer contributions under a qualified group legal services plan generally are allowed as a trade or business expense deduction to the employer (Code sec. 162).

Tax-exempt status of plan trusts. The income tax exemption for a trust or other organization which forms a part of a qualified group legal services plan (Code sec. 501(c)(20)) is scheduled to expire with the organization's first taxable year ending after December 31, 1981.

Notification. In order to be treated as a qualified group legal services plan, the plan must notify the Internal Revenue Service that it is applying for recognition of its qualified status. If the plan notifies the Service within the time prescribed by Treasury regulations (generally, before the end of the first plan year), the plan will be recognized as a qualified plan from its inception. Otherwise, the plan will be treated as qualified only from the date it actually provides notice.

Issue

The issue is whether the exclusion from an employee's income for employer contributions to and benefits provided under a qualified group legal services plan and the tax exemption of an organization which forms a part of such a plan, now generally scheduled to expire December 31, 1981, should be extended, and if so, whether such provisions should be made permanent.

Explanation of the bill

The bill would make permanent provisions of present law (income exclusion for employees and exempt status for plan trusts) relating to qualified group legal services plans.

Effective date

The provisions of the bill would be effective on enactment.

Revenue effect

It is estimated that the bill would reduce budget receipts by $18 million in fiscal year 1982, $29 million in 1983, $34 million in 1984, $40 million in 1985, and $48 million in 1986.

PREPARED STATEMENT OF SENATOR DOLE

Mr. Chairman, today we hear the views of the public on several miscellaneous measures. While these proposals are, of course, of great interest to those relatively small groups of taxpayers that will benefit from them, this Senator hopes such special measures will wait for a second bill and not encumber the first tax bill to be reported by the Finance Committee in this Congress.

Of the proposals to be considered, S. 1039, making permanent the exclusion from gross income of employer contributions to qualified legal services plans, should be looked at most closely. We must decide whether the provision of legal services, like health care and term life insurance, is such an important element in the employee-protection package that the Federal Government should use a subsidy to encourage employers to provide it to their employees.

The other bills appear to present simple technical corrections to code provisions or the noncontroversial extension or modification of code provisions in a logical manner.

Senator PACKWOOD. The hearing will come to order, please. We will start with the bill on prepaid legal insurance, S. 1039, and we have two panels this morning.

One, David R. Brink, James W. Bowles, and Stephen A. Bleyer, and we will start with that panel now.

It is good to have you with us this morning. Mr. Brink, why don't you start?

STATEMENTS OF DAVID R. BRINK, PRESIDENT-ELECT AMERICAN BAR ASSOCIATION, MINNEAPOLIS, MINN.; JAMES W. BOWLES, OREGON PREPAID LEGAL SERVICES; AND STEPHEN A. BLEYER, PHILADELPHIA, PA.

Mr. BRINK. Thank you.

Mr. Chairman, my name is David R. Brink. I am currently the president-elect of the American Bar Association. I am also a lawyer practicing in Minneapolis, Minn.

My purpose today is to state the American Bar Association's strong support for S. 1039, which as you know, would make permanent section 120 of the Internal Revenue Code.

As you well know, section 120 establishes the concept of a qualified legal services plan. It provides that employees may exclude from their taxable incomes, contributions made by an employer to such a plan or the value of any legal services received by the employee under the plan.

The real significance of section 120, of course, is that it makes it possible for employers to provide legal services as a benefit to employees in the same way that they provide health care benefits.

The section is, therefore, a means by which middle income Americans can afford the legal assistance they need to gain full access to our justice system.

Unfortunately in the past, many Americans encountered legal problems that go unresolved because legal fees are not anticipated or otherwise provided for in their monthly budgets as are some other needed items.

For example, medical care is usually provided through employer payments or monthly deductions from the paycheck. So, before group legal plans, legal fees when they were incurred had to come out of money left over at the end of the month. Money for which in the case of many Americans, there simply does not exist.

The survey of the legal needs of the public conducted by the American Bar Foundation beginning in 1974 indicates that more

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than 35 percent of the population in a year's time, encounter problems that could be solved by a lawyer, but that only 10 percent actually seek legal assistance without a plan.

By contrast, our information in the plans we are familiar with is that an average of 20 percent of the covered employees in a group plan seek legal services each year. This tends to show that twice as many people are enabled to obtain legal assistance in resolving everyday legal problems by participating in a group plan.

These employer users in the main are receiving prevent legal services that often make it possible to avoid litigation or serious or protracted remedial services.

Thus, group legal plans tend to preserve and employee morale and productivity and certainly assist in unblocking our overburdened judicial system.

The ABA commenced its support for legislation like this in 1974. In 1976, of course, Congress enacted this legislation, building in wisely, I think, a sunset provision to permit review after 5 years experience which we have now had.

During that interval the Internal Revenue Service has proposed some regulations with which the ABA does not necessarily fully agree. We believe and hope that those regulations can be adjusted through the administrative process, but we certainly would be glad to offer our assistance should verifying legislation seem to become necessary.

The past 5 years, however, have shown marked increases in the number of group legal plans and participants. Participants receive better preventive services and employers find better morale and productivity among employees and our society comes a significant step closer to achieving our ideal of equal justice for all our citizens.

The ABA believes the time has come to make permanent the concept of the qualified group legal services plan and we, therefore, strongly urge that passage of S. 1039.

The CHAIRMAN. Mr. Brink, I couldn't agree with you more with your statement. I was the principal sponsor of this bill when it passed and it is one of those few bills where everything has worked out as we hoped it would work out. Almost everything we did foresee came to pass.

None of the hitches that the opponents we had at that time have occurred. I know the problems you mentioned with the IRS. I think I can assure you before we get to markup on this, if we have not resolved our differences with the IRS, we will simply write those into the statute also so that they do not put some stumbling blocks in our way.

In my mind they are looking for excuses to make these plans not work and it—I don't use the word very often—but it is nitpicking. They are attempting to write into law things that we thought about and decided we did not want those impediments in the law. They are trying to put them there now.

Mr. BRINK. That is most encouraging, Senator. Thank you very much.

Senator PACKWOOD. Mr. Bowles.

Mr. BOWLES. Thank you, Senator.

Senator PACKWOOD. It is good to have you with us.

Mr. BOWLES. I am James Bowles. I appear as executive director of Oregon Prepaid Legal Insurance, Inc. which is commonly referred to in Oregon as OPL.

OPL is an Oregon nonprofit service corporation created in 1973 as a result of a study prepared by the prepaid legal committee appointed by the board of governors of the Oregon State Bar.

The program was designed and operates to meet personal legal service needs of Oregon's middle-income working people. The plan is sponsored by the Oregon State Bar, but operates independently and is underwritten by Midwest Mutual Insurance Co.

I appear before this committee in support of S. 1039 to make permanent the tax provision enacted in 1976 which was designated to encourage employers to provide prepaid legal services for their employees.

The Oregon plan provides a broad range of prepaid legal services. The cornerstone of which in our program provides what is termed preventive legal services and includes advice in regard to virtually any personal legal problem or transaction, consultation, document review, document preparation.

The plan also includes such benefits as nonbusiness bankruptcy, dissolution of marriage, separation or annulment, court adoption proceedings, insanity and infirmary proceedings, juvenile court proceedings, traffic matters, defense of criminal charges, and defense of civil actions.

Legal services are provided by over 1,400 participating attorneys located throughout Oregon who agreed to accept what the plan pays as payment in full, thus eliminating almost all out-of-pocket expense for attorney fees for the plan participants.

The plan is designed to encourage beneficiaries to take care of legal matters if necessary before they become troublesome. To prevent waiting until it is too late, so to speak.

During the first 3 years of OPL's existence, we were able to sell only two plans covering just over 100 beneficiaries. Employers were unwilling to fund legal service benefits until the crust of the benefits could be exempt income to the employees and could be treated and administered in the same manner as other recognized and qualified health and welfare benefits.

OPL has added 26 new groups and currently provides personal legal service benefits for over 3,000 Oregon families. Oregon employers are obviously now more open to providing legal service benefits and organized labor units are now including legal service benefits in bargaining sessions at the request of their membership.

We strongly support Senate bill 1039. We have had the opportunity to observe OPL's growth despite higher unemployment and adverse economic conditions. The growth indicates to us just how much the working people of Oregon really do need the services of attorneys.

In the past, people of moderate means, working people, have not received personal legal services they need. The main reason is cost and money.

They feel they cannot afford what lawyers charge. They forgo timely legal advice when it could help them avoid future problems. They go without essential legal representation because they are not

in a position to pay and without those services they suffer financial and emotional setbacks.

For many of them, another problem is accessibility. They do not know how to find a lawyer who is responsible and interested in their problems.

The Oregon program is providing access to lawyers and provides necessary legal services to plan beneficiaries at an extremely low cost.

From firsthand experience we can definitely state that the future of prepaid legal services depends on the continuation of tax-exempt status.

In conclusion and speaking for 3,000 Oregon families now covered by prepaid legal service plans and for hundreds of thousands more who need and want group legal benefits, I ask for your positive support to make the tax-exempt status of the qualified plans permanent.

Thank you.

Senator PACKWOOD. Mr. Bowles, thank you for having a paternalistic interest in this bill. I have followed your endeavors successfully and I hope that you have 12,000 to 15,000 families before another year or two is out.

Our experience with other States is when this takes off, it takes off quite rapidly.

Mr. BOWLES. Yes.

Senator PACKWOOD. Mr. Bleyer.

Mr. BLEYER. Good morning. I am Stephen A. Bleyer and I appear on behalf of the Federal Tax Division of the American Institute of Certified Public Accountants.

Internal Revenue Code, section 120, as currently drafted, gives no clear guidance as to what the term legal services is intended to encompass. Neither do the committee reports give any indication as to the scope of the term.

Proposed regulations issued by the Internal Revenue Service on April 29, 1980, concerning qualified group legal service plans define legal services as services performed by a lawyer if the performing of the services constitutes the practice of law.

Furthermore, legal services may include services performed by a person who is not a lawyer only if the service is performed under the direction or control of a lawyer in connection with the legal service performed by the lawyer and the fee for this service is included in the legal fee of the lawyer.

Legal services as so defined would appear to include the preparation of the tax return and the rendering of tax advice when done by a lawyer or under his control, while at the same time such services can be legally performed by a CPA acting on his own and yet in that instance would not be includible as part of a qualified group legal services plan.

Additionally, there are many financial and estate planning related services that can be legally performed by CPA's, banks, insurance companies, stock brokers, certified financial planners, and others, as well as by attorneys.

The effect of the proposed regulations would be to give attorneys a competitive advantage over all of these groups in these areas.

Fees paid by the employer on behalf of the employee for tax services would, of course, currently be handled under the normal rules of the code, sections 162 and 212.3.

This however, is not an adequate remedy since the employee would have to include reimbursements in his income and then might receive a corresponding itemized deduction for them.

In the case of a rank-and-file employee of a major corporation, it is very possible that this employee would not be in a position to itemize his deductions. Thus, in the case of tax services performed by a CPA, acting on his own for an employee of that corporation, where the CPA's fee was reimbursed to the employee by the corporation, the employee who does not have sufficient itemized deductions would have additional taxable income to the extent of the reimbursed fee with no offsetting deductions.

Furthermore, such rank-and-file employees appear to be the very ones that qualified group legal services provisions are intended to assist.

In an instance such as the one just cited, a corporation would, to most fully benefit its employees, probably leave all tax counseling to the attorneys, since the tax advice provided by them would be includable under the qualified group legal services plan, thereby depriving CPA's of potential business.

It would also appear to be administratively easier for the corporation to have tax services handled through the plan rather than to incur the additional expense and effort required by providing these services outside the plan.

In light of the ambiguities of Internal Revenue Code, section 120, as currently drafted and as illustrated by the proposed regulations cited above, we feel that any legislation enacted to make permanent the exclusion from gross income of employer-provided legal services benefits should contain language to clarify the definition of the term "legal services."

This clarification could be accomplished in one of two ways. The statutory language of section 120 could be changed to provide for an expansion of the services allowable under the current group legal services plan rules so that tax services provided by a CPA, an enrolled agent, or a public accountant, working independently of an attorney would be permissible as part of the plan.

The AICPA feels this solution is the more appropriate. An alternative, however, would be to provide that the term "legal services" will be strictly construed to mean services that can only be legally performed by a lawyer. This will eliminate the potentially discriminatory treatment in favor of attorneys and allow equal treatment where the same service is legally performed by other professionals. With this change, any reimbursements made by an employer to an employee for tax services would be handled under the normal rules of sections 162 and 212.

Either of these solutions certainly seems to be in keeping with the overall policies of the Federal Government, which have always been to encourage competition. Furthermore, the intent of the legislation is to promote prepaid legal services plans for rank-and-file employees and not to provide attorneys with a competitive advantage and stifle competition in the area of tax services.

I want to thank you on behalf of the AICPA for the opportunity to present our position.

Senator PACKWOOD. You raise a very valid point and I can assure you it is one that never occurred to me. In the past, there was no discussion and that is not unique; it happens frequently. The issue just never occurred to us and I think it is one we should resolve.

Mr. BLEYER. Thank you.

Senator PACKWOOD. I have no questions. Senator Matsunaga, do you have any questions?

Senator MATSUNAGA. Thank you, Mr. Chairman. Being the father of a lawyer and a CPA, I wonder what Mr. Bowles' view on Mr. Bleyer's comment is.

Mr. BOWLES. It is interesting. The beneficiary groups that we are in contact with, the actual employees, those labor organizations, getting tax advice is important to them I think. They talk about it.

The problem needs to be researched and developed. I think it would be good.

Senator MATSUNAGA. The question really is where those legal services begin and end.

Senator PACKWOOD. I practiced law for 10 years, mostly labor law. Then, many people, if not most, went to CPA's who were better qualified to give tax advice than I was. It was not my field of law and yet I can see that under this plan, people would come and ask for tax advice of a lawyer who is simply not in a position to give it, and probably should not give it.

It is a really valid point.

Mr. BLEYER. Thank you.

Senator PACKWOOD. Gentlemen, thank you very much. I appreciate it.

[Prepared statements of the preceding panel follow:]

PREPARED STATEMENT OF DAVID R. BRINK

Dear Mr. Chairman and Members of the Subcommittee: My name is David R. Brink. I am currently the President-Elect of the American Bar Association. I am also a lawyer practicing in Minneapolis, Minnesota. My purpose today is to state the American Bar Association's strong support for S. 1039, which, as you know, would make permanent Section 120 of the Internal Revenue Code.

As the Committee knows, Section 120 establishes the concept of a "qualified legal services plan." It provides that employees may exclude from their taxable incomes contributions made by an employer to such a plan or the value of any legal services received by the employee under the plan.

The real significance of Section 120 is that it makes it possible for employers to provide legal services as a benefit to employees the same way as they provide health care benefits. The Section is therefore a means by which middle income Americans can afford the legal assistance they need to gain full access to our justice system.

Unfortunately, many Americans encounter legal problems that go unresolved because legal fees are not anticipated in their monthly budgets as are other needed items. Medical care is provided through employer payments or monthly deductions from the paycheck. Food, housing, an automobile, life insurance and other items are usually paid for on a monthly basis. Before group legal plans, legal fees, when incurred, had to come out of money left over at the end of the month, money which for many Americans simply does not exist.

A comprehensive 1974 survey of the legal needs of the public conducted by the National Opinion Research Center for the American Bar Foundation indicates more than 35 percent of the population, in a year's time, encounter problems that could be solved by a lawyer, but that only 10 percent actually seek legal assistance. By contrast, our information is that an average of 20 percent of the covered employees in a group plan seek legal services each year. This tends to show that twice as many people are enabled to obtain legal assistance in resolving everyday legal problems by participating in a group plan.

These employee-users, in the main, are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. Thus, group legal plans tend to preserve employee morale and productivity and assist in unblocking our overburdened judicial system.

The ABA commenced its support of similar legislation in 1974. In 1976, Congress enacted the legislation, wisely building in a "sunset" provision to permit review after five years of experience. During that interval, the Internal Revenue Service has proposed regulations with which the ABA does not necessarily fully agree. We believe that the regulations can be adjusted through the administrative process, and would be glad to offer our assistance should clarifying legislation become necessary.

The past five years, however, have shown marked increases in the number of group legal plans and participants. The participants receive better preventive services, employers find better morale and productivity among employees and our society comes a significant step closer to achieving our ideal of equal justice for all our citizens.

The ABA believes the time has come to make permanent the concept of the qualified group legal services plan. We therefore strongly urge the passage of S. 1039.

Prepared Statement of James W. Bowles

I am James W. Bowles. I appear as Executive Director of Oregon Prepaid Legal Insurance Inc. (OPL). OPL is an Oregon non-profit service corporation created in 1973 as a result of a study prepared by the prepaid legal committee appointed by the Board of Governors of the Oregon State Bar. The program was designed and operates to meet the personal legal service needs of Oregon's middle income working people. The plan is sponsored by the Oregon State Bar, but operates independently, and is underwritten by Midwest Mutual Insurance Company.

I appear before this committee in support of Senate Bill 1039 to make permanent the tax provision enacted in 1976, which was designed to encourage employers to provide prepaid legal services for their employees.

The Oregon plan provides a broad range of prepaid legal services. The cornerstone of our program provides what is termed preventative legal services and includes advice in regard to virtually any personal legal problem or transaction, consultation, document review and document preparation. The plan also covers: Non-business bankruptcy; dissolution of marriage, separation or annulment; court adoption proceedings; insanity or infirmity proceedings; juvenile court proceedings; traffic matters; defense of criminal charges; and defense of civil actions.

Legal services are provided by over 1,400 participating attorneys located throughout Oregon who agree to accept what the plan pays as payment in full, thus eliminating almost all out-of-pocket expense for attorneys' fees.

The plan is designed to encourage the beneficiaries to take care of legal matters as necessary before they become troublesome, to prevent "waiting until it's too late" so to speak.

During the first three years of OPL's existence we were able to sell only two plans, covering just over 100 beneficiaries. Employers were unwilling to fund legal service benefits until the cost of the benefits could be considered exempt income to the employees and could be treated and administered in the same manner as other recognized and qualified health and welfare benefits.

OPL has added 26 new groups and currently provides personal legal service benefits for over 3,000 Oregon families. Oregon employers are obviously now more open to providing legal service benefits and organized labor units are now including legal in bargaining sessions at the request of their memberships.

We strongly support Senate Bill 1039. We have had the opportunity to observe OPL's growth despite higher unemployment and adverse economic conditions. The growth indicates to us just how much the working people of Oregon really do need the services of attorneys.

In the past people of moderate means—working people—have not received the personal legal services they need. The main reason is money. They feel they cannot afford what lawyers charge. They forego timely legal advice when it could help them avoid future problems. They go without essential legal representation because they are not in a position to pay—and without those services they suffer financial and emotional setbacks.

For many of them another problem is accessability. They do not know how to find a lawyer who is responsive and interested in their problems.

The Oregon program is providing access to lawyers and provides necessary legal services for plan beneficiaries at an extremely low cost.

From first hand experience we can definitely state that the future of prepaid legal services depends on the continuation of tax exempt status.

In conclusion, and speaking for 3,000 Oregon families now covered by prepaid legal services plans and for hundreds of thousands more who need and want group legal benefits, I ask for your positive support to make the tax exempt status for qualified plans permanent.

PREPARED STATEMENT OF STEPHEN A. BLEYER

Good morning. I am Stephen A. Bleyer, and I am appearing on behalf of the Federal Tax Division of the American Institute of Certified Public Accountants.

Internal Revenue Code Section 120, as currently drafted, gives no clear guidance as to what the term "legal services" is intended to encompass. Neither do the Committee reports give any indication as to the scope of the term.

Proposed regulations issued by the Internal Revenue Service on April 29, 1980 concerning qualified group legal services plans define "legal services" as services performed by a lawyer, if the performing of the services constitutes the practice of law. Furthermore, "legal services" may include services performed by a person who is not a lawyer, only if the service is performed under the direction or control of a lawyer, in connection with a legal service performed by the lawyer, and the fee for the service is included in the legal fee of the lawyer.

"Legal services," as so defined, would appear to include the preparation of a tax return and the rendering of tax advice when done by a lawyer, or under his control; while at the same time, such services can be legally performed by a CPA acting on his own and yet, in that instance, would not be includable as part of a qualified group legal services plan. Additionally, there are many financial and estate planning-related services that can be legally performed by CPA's, banks, insurance companies, stock brokers, Certified Financial Planners and others, as well as by attorneys. The effect of the proposed regulations would be to give attorneys a competitive advantage over all of these groups in these areas.

Fees paid by the employer on behalf of the employee for tax services would, of course, currently be handled under the normal rules of Sections 162 and 212(3). This, however, is not an adequate remedy, since the employee would have to include reimbursements in his income and then might receive a corresponding itemized deduction for them. In the case of a rank-and-file employee of a major corporation, it is very possible that this employee would not be in a position to itemize his deductions. Thus in the case of tax services performed by a CPA, acting on his own, for an employee of that corporation, where the CPA's fee was reimbursed to the employee by the corporation, the employee who does not have sufficient itemized deductions would have additional taxable income to the extent of the reimbursed fee, with no offsetting deduction. Furthermore, such rank-and-file employees appear to be the very ones that the qualified group legal services provisions are intended to assist.

In an instance such as the one just cited, a corporation would, to most fully benefit its employees, probably leave all tax counselling to the attorneys, since the tax advice provided by them would be includable under the qualified group legal services plan, thereby depriving CPA's of potential business. It would also appear to be administratively easier for the corporation to have tax services handled through the plan rather than to incur the additional expense and effort required by providing these services outside the plan.

In light of the ambiguities of Internal Revenue Code Section 120, as currently drafted and as illustrated by the proposed regulations cited above, we feet that any legislation enacted to make permanent the exclusion from gross income of employer-provided legal services benefits should contain language to clarify the definition of the term "legal services."

This clarification could be accomplished in one of two ways. The statutory language of Section 120 could be changed to provide for an expansion of the services allowable under the current group legal services plan rules so that tax services provided by a CPA, an enrolled agent, or a public accountant, working independently of an attorney, would be permissible as part of the plan. The AICPA feels this solution is the more appropriate. An alternative, however, would be to provide that the term "legal services" will be strictly construed to mean services that can *only* be legally performed by a lawyer. This will eliminate the potentially discriminatory treatment in favor of attorneys and allow equal treatment where the same service is legally performed by other professionals. With this change, any reimbursements made by an employer to an employee for tax services would be handled under the rules of Section 162 and 212(3).

Either of these solutions certainly seem to be in keeping with the overall policies of the federal government, which have always been to encourage competition. Furthermore, the intent of the legislation is to promote prepaid legal services plans for rank-and-file employees and not to provide attorneys with a competitive advantage and stifle competition in the area of tax services.

I want to thank you on behalf of the AICPA for the opportunity to present our position.

If you have any questions, I will be happy to try to answer them.

Senator PACKWOOD. We will conclude S. 1039 with a panel of Arthur Ericson, Richard Scupi, and Sandra Dement.

Mr. Ericson.

STATEMENTS OF ARTHUR W. ERICSON, VICE PRESIDENT AND ASSOCIATE ACTUARY, PRUDENTIAL INSURANCE CO. OF AMERICA; RICHARD SCUPI, DIRECTOR, UAW LEGAL SERVICES PLAN; AND SANDRA DEMENT

Mr. ERICSON. Thank you, Senator. My name is Arthur Ericson and I am vice president and associate actuary in the Group Insurance Department of the Prudential Insurance Co. of America. I am accompanied today by Ted Groom of Groom & Nordberg, Washington counsel to Prudential.

Before offering my comments on S. 1039, I would like to express our appreciation to you, Mr. Chairman, for your help in furthering the development of group legal services plans.

I would also like to say that like Prudential, a number of other major insurance companies offer or are considering offering group legal insurance plans including John Hancock Mutual Life Insurance Co., the Equitable Life Assurance Society of the United States, Aetna Life & Casualty Co., and Connecticut General Life Insurance Co.

The companies I have named have reviewed and endorsed this statement on S. 1039.

Although the number of group legal service plans established during the past few years may be relatively small, we believe that many more plans will be established in the future if the tax exclusion for contributions and benefits is made permanent.

The exclusion provides a meaningful impetus for the development of group legal services plans and it should be made permanent. We strongly support S. 1039.

At the same time we agree with you, Senator, that currently proposed rules for qualifying for the exclusion are unduly restricted in some respects.

Senator PACKWOOD. They look like they were almost intentionally drafted to prohibit qualifying.

Mr. ERICSON. In many respects, yes sir, they do.

When you introduced your bill, Senator, you identified several aspects of the current rules which are of concern to you and they are of concern to us as well. While we recognize that the most important current legislative goal for group legal services plans is to make the tax exclusion permanent, it is also important to resolve other problems related to tax exclusion at the earliest possible time and therefore, we ask the subcommittee to address these problems in connection with its consideration of S. 1039.

While the areas of concern which you mentioned is the limitations on initial consultations with a lawyer. This is an area of great concern to us. The regulations place limits on the extent to which a

qualified plan may provide initial consultations and the way in which a lawyer may conduct an initial consultation.

In my written comments, I refer to several statistical facts and reasons which I believe support the need for unlimited consultations in these plans.

Therefore, we ask the subcommittee to amend S. 1039 by adding a provision to make it clear that initial consultations under qualified plans are not limited.

Another area of concern, which you mentioned, is the excessive restrictions on employee contributions and this is also of great concern to us. The proposed regulations virtually prohibit employee contributions under qualified plans.

Again, in my written comments on this matter, I cite two important reasons for our belief that employee contributions under qualified plans should be allowed.

There are several other areas that you identified and also concern us. One of these is the excessive restrictions on the definition of personal legal services. We support an amendment to code section 120 to define the term personal legal services as legal services other than legal services primarily related to the conduct of a trade or business of an employee, his spouse or dependent.

Another area is reliance on actual utilization rates of planned benefits to determine if a plan is entitled to qualification. Actual utilization rates of legal services generally are fortuitous and therefore, unpredictable.

Thus, reliance on such rates for purposes of determining plan qualification is likely to deter the establishment of new plans, especially for small employers.

We prefer that actual utilization rates not be used in determining plan qualification.

A related problem which is associated with the statutory limitation on contributions for shareholders is the fortuity of employment levels. Because of the unpredictability of employment levels, the 25 percent limitation on contributions for shareholders is likely to be a strong deterrent to the establishment of group legal services plans again for small employers.

We believe that the subcommittee should explore ways of making qualified group legal service plans a more feasible alternative for small employers.

We would be happy to cooperate with the subcommittee in this endeavor.

We thank you for this opportunity, Senator, to present our views. We strongly support S. 1039 and we hope that the subcommittee will also expand the bill in the ways that we have suggested. Thank you.

Senator PACKWOOD. I will be very surprised if we can't make this permanent. The objections that were initially raised have simply faded away and I don't think those objections exist anymore.

I think we can accomplish most of the changes to take care of the IRS problems, either simply ruling over them or getting them to change their views.

Mr. ERICSON. Well, Senator, I am pleased to hear that.

Senator PACKWOOD. Thank you. Mr. Scupi.

Mr. SCUPI. Thank you. Mr. Chairman, my name is Richard Scupi. I am the director of the UAW legal services plan.

In early 1978, the UAW legal services plan received the first 501(c)(20) ruling from the Internal Revenue Service. We are here today to testify in strong support of S. 1039, in its present form.

I will give just a brief version of my prepared statement, but I would like my full statement to go on the record.

Prepaid legal services carries great promise for fulfilling one of the oldest dreams of democracy under the rule of law—to give each citizen not only equal rights but also the means to pursue and defend those rights.

It is the increasing awareness of this promise for prepaid legal services that created significant interest in prepaid legal services as an employment fringe benefit.

In 1976, Congress recognized this interest by enacting section 120 for a temporary 5-year period.

Enactment of section 120 was an important breakthrough as it permitted unions to collectively bargain for prepaid legal services. UAW immediately seized the opportunity to establish a model prepaid legal services programs.

The UAW legal services plan is a national prepaid pilot program which provides personal legal services for hourly workers, retirees, for hourly positions and for the families of such employees and retirees.

By early 1979, the plan was operational on a nationwide basis providing prepaid legal services to its participants.

In contrast to the traditional methods of providing professional services, where the professionals control the costs and quality of their services, the plan's structure places cost and quality controls over professional services in the hands of people representing consumer interests.

In a little more than 2 years of operation, more than 50,000 cases have been opened by the plan for its participants.

Unfortunately, the 2 years of the plan's operations have coincided with a period of economic distress for many of the plan's participants because of the problems in the auto industry, so there has been unexpectedly heavy reliance by laid-off workers on the plan.

Consequently, the plan's existence has enabled many participants to exercise their rights effectively when it was of great importance to them to receive legal assistance.

Comments from participants using the plan's benefits illustrate the importance during a period of layoff of personal legal services provided on a prepaid basis.

An assembly line worker from Illinois wrote:

> I think this program is a wonderful program for those of us who make too much money to qualify for the poor class and not enough to say we are rich.

A recent retiree from Florida wrote:

> I think this is a very good thing for the retirees—they have to live on a small pension and can't afford the expense.

The cost of providing personal legal services through the delivery systems employed by the plan are modest, indeed. The cost of providing benefits to each eligible family in 1981 will be about $30 per family.

We believe, along with UAW, that there is a great unmet need for legal services amongst American workers and their families.

We are committed to this first step in meeting that need. But, we are also committed to meeting that need from a consumer's point of view.

That means providing high quality effective services and to do so in a way that will solve problems without creating a whole new set of problems by building into the delivery systems, predictable cost escalations.

The early experiences of the UAW legal services plan demonstrate that providing high quality legal services in an economical manner is possible through a combination of several delivery models, each a component of a national legal services program.

We have no question, based on our experience, that the plan is serving a vital purpose and meeting needs that would otherwise not be met.

The plan's 501(c)(20) status and section 120's provisions are, of course, indispensable to the continuation of the plan. Since section 120 will expire at the end of 1981 unless S. 1039 is enacted, we strongly support S. 1039.

I might say in conclusion in reference to some comments that have been made, that at this point we also believe the main priority is to make section 120 permanent and therefore, we strongly support S. 1039 in its present form.

Senator PACKWOOD. Mr. Scupi, it may be in your testimony—I didn't find it—is this entirely employer paid by payroll deduction?

Mr. SCUPI. There are not current contributions. The plan is funded entirely from a trust fund that was collected in the early 1960's for a backup subfund.

The main subfund was renegotiated and it made the backup fund superfluous so it sat there for 15 years and in the late seventies the UAW decided to try and persuade the employees to convert it to a prepaid legal services program when 120 was enacted.

So, actually there is about $20 million there and we are just funded from that. There are no current contributions to the program at this time.

Senator PACKWOOD. In one of the pamphlets you left is on a Chrysler plan. Do you have it for all of the companies?

Mr. SCUPI. No, this trust fund that I am talking about was contributed entirely by Chrysler hourly workers in the United States, so the participants are limited for that group into the retirees from that group.

Senator PACKWOOD. OK. Do you have a sufficient fund to keep this plan growing or is this going to have to go as a negotiable item sooner or later to cover its continued costs?

Mr. SCUPI. The UAW's plans are to put it on the bargaining table with employers and to try to get current funding for it by 1985.

Senator PACKWOOD. Thank you.

The last witness on this panel and on this subject is Sandra Dement. I would just like to say that if I am the parent of this bill in the Senate, she was certainly the midwife that made it pass. She was the principal lobbyist. It would not have passed without her and there is probably nobody as well versed in the history of this plan as is Sandy.

Sandy.

Ms. DEMENT. Thank you very much. I am here today representing the National Resource Center for Consumers of Legal Services which is an organization representing the consumer and labor interests. It is an organization which worked for nearly 10 years to encourage the development of legal service plans as a means of improving citizen access to the courts.

We are strongly supporting S. 1039. Let us briefly define what we are talking about with these plans. We are talking about employee benefit plans that provide personal legal services—wills, divorces, real estate, and consumer matters.

Most of them are now beginning to provide telephone advice and consultation which has an important preventive role effect.

We are talking about plans that provide civil litigation defense and in many cases also criminal defense.

The plans do not cover business matters and they do not cover suits against the employer.

From a firm for the Resource Center we have determined that the largest category of plans covering the most people are employer-funded plans. The second largest category are plans that are unilaterally funded by unions and the third category, which is hard to calculate numerically, are a collection of plans established by student groups in universities, by consumer cooperatives, by credit unions and so forth.

They range in size from less than 100 covered persons per plan to over 100,000, so we are not talking about plans that are designed for the large employer and his employees particularly nor for the small but they are universally appropriate.

Their cost appears on an average basis to be less than $100 per family per year. They are a bargain. We would estimate roughly that the average cost of plans is probably somewhere in the neighborhood of $75 per family per year.

The first-employer funded plans were not established until 1974. Today, the Resource Center files suggest we have records of plans covering approximately half a million people. These, again, are just the employer-funded plans.

These plans were established in reliance on series of steady signals from Congress over the years in support of them. The first of those was the amendment in 1973 of the Taft-Hartley Act which signaled that Congress determined legal service plans provided through the private sector were an appropriate means of increasing citizen access to the courts.

Additionally, in 1974, the enactment of ERISA reinforced the idea of congressional judgment that legal service plans are appropriately a part of the wage and compensation system. That is an appropriate way to achieve improved access to the court system.

And, finally, in 1976 the Tax Reform Act was enacted with section 120 which places legal services on an equal tax footing with medical benefits makes it, from an economic point of view, a sensible benefit.

Again, in 1978 Congress enacted an amendment defining for purposes of FICA and FUDA, major withholding, excluding from the definition of wages amounts contributed to legal service plans. Again, extending to legal service plans equal tax treatment with other kinds of similar benefits.

As the result of these congressional steps, we have seen a burst of development through the private sector of plans through the actions of employers, unions, the bar associations, insurance companies, benefit administrators, and others.

I want to say a brief word or two about revenue loss, although that certainly would be the province of the Treasury Department to make the definitive statement in that area.

Given our estimate or identification of approximately half a million covered people under employer-funded plans, we, of course, make no claim that we know about all the plans that are out there. We would believe that there are something between half a million and 1 million covered plans.

The revenue loss on the value of benefits provided through those plans is calculated making certain assumptions on the average benefit amount, the average utilization rate, but it would range between $7.50 to $12 per covered family. So, we are looking in the aggregate of something if you make lower assumptions, half a million covered, 15-percent utilization, $250 average claim, you would come up with an annual revenue loss of figure of $3.75 million.

If you make higher assumptions, assuming 40-percent utilization, $300 average claim, as many as 1 million people covered, you are still only looking at a $12 million annual revenue loss figure.

I would conclude by saying that we concur with the comments that have been made about the IRS regulations. They're obstructive and particularly as regards to the definition of legal services and as regards to the ability of employees to contribute to plans, they are damaging.

The growth and development of these plans rests, like a three-legged stool, on three fundamental supports.

The first was the series of decisions by the Supreme Court that said that these plans have fundamental protection under the first amendment.

The second was the enactment by Congress of the Taft-Hartley Act which placed the plans in the context of the collective bargaining sector and which signaled a determination that they are an appropriate means of achieving improved access to the courts through the private sector.

Finally, the third leg in our three-legged stool is section 120 which provides equal tax treatment to other fringe benefits and I would suggest in our strong support of S. 1039 is based on a conviction of what happens to a three-legged stool when you take one leg away.

Thank you.

Senator PACKWOOD. Sandy, don't worry about the revenue loss. I discovered in my service on the Budget Committee, that first we round everything to the nearest $100 million. And I discovered when I was on that committee I could get any number of small programs accepted that I liked if they cost less than $50 million because in theory they cost nothing if you round them down.

Anything that is less than $100 million is just an asterisk. We don't even count it. I mean, we just add all the asterisks together and figure what we have roughly, which may account for the deficits we incur from time to time.

Ms. DEMENT. I recall that the revenue loss questions were of great concern originally. I think the records suggest that not only are the plans not expensive today, but even if over time a great many millions of people are covered by the plans, the revenue losses will be quite modest.

Senator PACKWOOD. Treasury may oppose it, but I cannot believe it would be the problem we had when we first went through this.

When Sandy and I were working on this, it was opposed by the chairman of the Finance Committee, by the chairman of the Ways and Means Committee, by the President and by the Secretary of the Treasury. Despite all of that, we managed to get it through and I cannot conceive that we are going to have one one-hundredth of the problems this time.

Senator Matsunaga, do you have any questions?

Senator MATSUNAGA. Thank you. I was very much impressed, of course, with all the testimony and by the fact that by the testimony of Mr. Scupi in a little more than 2 years of operation, more than 50,000 cases have been opened by the plan for participants.

How many lawyers were involved in the handling of the 50,000 cases?

Mr. SCUPI. About 80 percent of our cases are handled by staff lawyers. That is, employees of the plan. The other 20 percent are handled by several hundred what we call cooperating attorneys so the total number of staff lawyers is about 60.

Senator MATSUNAGA. Sixty.

Mr. SCUPI. The total number of cooperating attorneys that we have contracts with is about 600.

Senator MATSUNAGA. Six hundred and sixty. And this is just for the employees of Chrysler Motors?

Mr. SCUPI. Well, most of the retirees have their problems handled by cooperating attorneys. That is attorneys in private practice, because they live in States like Florida or Hawaii.

In the Detroit area, for example, we have staff attorneys and employees who handle most of the cases.

Senator MATSUNAGA. That is quite an extensive number of lawyers. I heard over the radio a news item saying that in all of Peking there were only 76 lawyers.

Senator PACKWOOD. Trials are much shorter there.

Senator MATSUNAGA. In New York City, alone, there are over 4,000 lawyers I am told. So, that, I think, proves the success of the efforts of people like you and like Sandy and others who have been working toward bringing legal services to the general population who are otherwise unable to obtain such legal services and those who hardly ever see attorneys in their whole lifetime.

Thank you very much.

Senator PACKWOOD. Thank you very much. I appreciate your testimony.

Mr. ERICSON. Thank you.

Mr. SCUPI. Thank you.

Ms. DEMENT. Thank you.

[Prepared statements of the preceding panel follow:]

SUMMARY OF PRINCIPAL POINTS IN THE PREPARED STATEMENT BY ARTHUR W. ERICSON

Mr. Ericson is Vice President and Associate Actuary in the Group Insurance Department of the Prudential Insurance Company of America. His prepared statement on S. 1039 has been endorsed by John Hancock Mutual Life Insurance Company, The Equitable Life Assurance Society of the United States, Aetna Life and Casualty Company, and Connecticut General Life Insurance Company.

Mr. Ericson's statement incudes the following principal points:

"We strongly support S. 1039. In order for pre-paid legal services plans to play a meaningful role in employee benefit programs, it is imperative that the tax exclusion for contributions and benefits under qualified group legal services plans be made permanent. Enactment of S. 1039 is needed to encourage the continuation of existing plans and the establishment of new plans.

"At the same time, we agree with Senator Packwood that currently proposed rules for qualifying for the exclusion are unduly restrictive in some respects. . . . The regulations under Code section 120 which were proposed by the Internal Revenue Service in April 1980 contain various unnecessary restrictions. . . . Because of the current uncertainty created by the proposed regulations, and because there is a broad consensus regarding the unfairness and undesirability of certain of their restrictions, we ask the Subcommittee to expand S. 1039 to eliminate the most objectionable of these restrictions."

In brief, Mr. Ericson recommends that S. 1039 be expanded in the following ways:

To make it clear that qualified group legal services plans are not required to limit initial consultations in any way;

To make clear that qualified plans may, without restriction, allow employees to make payments under the plan in any form;

To define "personal legal services" as legal services other than legal services primarily related to the conduct of a trade or business; and

To pervent or limit reliance on actual utilization rates of plan benefits for purposes of determining plan qualification.

PREPARED STATEMENT BY ARTHUR W. ERICSON

My name is Arthur W. Ericson. I am Vice President and Associate Actuary in the Group Insurance Department of The Prudential Insurance Company of America. I am accompanied today by Ted Groom of Groom and Nordberg, Washington counsel to Prudential.

Prudential is one of the largest underwriters and administrators of employee benefit plans in the country. Approximately 30,000,000 employees and dependents are insured under our 9,800 group insurance contracts.

I am here today to offer comments on S. 1039, a bill to make permanent the tax exclusion for contributions made by employers, and benefits received by employees, under qualified group legal services plans. Before beginning, I would like to express our appreciation to Senator Packwood for all he has done to promote the development of these plans. I would also like to say that, like Prudential, a number of other major insurance companies offer (or are considering offering) group legal insurance plans, including John Hancock Mutual Life Insurance Company, The Equitable Life Assurance Society of the United States, Aetna Life and Casualty Company, and Connecticut General Life Insurance Company. The companies I have named have reviewed and endorsed this statement on S. 1039.

Many major underwriters of employee benefit plans have been monitoring the development of group legal services plans since the early to mid-1970's. Today, some have indemnity contracts which have been approved by a number of insurance departments and are prepared to underwrite group legal services insurance programs. For a number of reasons, however, the industry has not perceived the development of legal services as a true group insurance benefit to be as rapid as wished for by many public interest groups. One of these reasons has been the temporary nature of the tax exclusion and the uncertainties associated with current rules for qualifying for the exclusion.

Nevertheless, it is our hope that pre-paid legal services plans will become an integral part of employee benefit programs. To this end, one of my responsibilities has been to guide Prudential into this market and to direct the development of a group insurance product. During this time, I have been a member of the Pre-paid Legal Services Committee of the New Jersey Bar Association, having served on its Subcommittee to draft legislation which authorizes the underwriting of legal services plans. Until recently, I have also served on an American Council of Life Insurance Subcommittee for New Forms of Employee Benefits, having been its chairman for the last two years.

We strongly support S. 1039. In order for pre-paid legal services plans to play a meaningful role in employee benefit programs, it is imperative that the tax exclusion for contributions and benefits under qualified group legal services plans be made permanent. Enactment of S. 1039 is needed to encourage the continuation of existing plans and the establishment of new plans.

Prudential's experience in development and providing group legal insurance indicates that the tax exclusion is doing exactly what Congress intended it to do. It is causing legal services to become more widely available to taxpayers, especially middle income taxpayers. As Congress also intended, the tax inclusion is providing taxpayers with some relief from the high cost of legal fees.

Although the number of group legal services plans established during the past few years may be relatively small, we believe that many more plans will be established in the future if the exclusion is made permanent. The exclusion provides a meaningful impetus for the development of group legal services plans, and it should be made permanent.

At the same time, we agree with Senator Packwood that currently proposed rules for qualifying for the exclusion are unduly restrictive in some respects. When Senator Packwood introduced S. 1039. he identified several aspects of the current rules which are of concern to him. We share the Senator's concern.

The regulations under Code section 120 which were proposed by the Internal Revenue Service in April 1980 contain various unnecessary restrictions. Although these restrictions were discussed extensively by witnesses at an IRS hearing last September, the proposed regulations still are outstanding. Final regulations to be issued by the IRS may provide some relief, but they are not likely to solve all of the problems.

Because of the current uncertainty created by the proposed regulations, and because there is a broad consensus regarding the unfairness and undesirability of certain of their restrictions, we ask the Subcommittee to expand S. 1039 to eliminate the most objectionable of these restrictions. We recognize that the most important current legislative goal for group legal services plans is to make the tax exclusion permanent. However, it is also important to resolve other problems related to the tax exclusion at the earliest possible time. Therefore, we ask the Subcommittee to address these problems in connection with its consideration of S. 1039.

INITIAL CONSULTATIONS

One of the areas of concern which Senator Packwood has identified is limitations on initial consultations with a lawyer. This is an area of great concern to us.

Since a qualified plan may provide only personal legal services, consultations must be held to determine whether a plan participant is in need of a personal legal service, and, if so, whether such service may be provided under the plan. The proposed regulations refer to these consultations as "initial consultations."

The regulations place limits on the extent to which a qualified plan may provide initial consultations and on the way in which a lawyer may conduct an initial consultation. In effect, the proposed regulations require qualified plans to limit the initial consultations available to any plan participant, either in time (no more than 4 hours of initial consultation during any year) or number (no more than 4 initial consultations during any year). The regulations also provide that an initial consultation must not include document preparation or review, or representation of the participant.

In our judgment, these limitations severely undermine the success of group legal services plans and serve no useful purpose. We strongly believe that qualified plans should not be required to limit initial consultations in any way. Therefore, we ask the subcommittee to amend S. 1039 by adding a provision to make it clear that qualified plans are not so required. This provision could simply amend Code section 120 to provide that the term "personal legal services" includes consultations held to determine whether a plan participant is in need of a legal service which may be provided under the plan.

In order to achieve their purpose of making legal services more widely available, and in order to be cost efficient, group legal services plans must provide plan participants with easy and frequent access to initial consultations. A survey on the legal needs of the American public which was conducted by the American Bar Association in 1974 shows the need for such access. Eighty percent of those surveyed did not know which lawyer could help them with their specific legal problem, and 62 percent felt that lawyers were too expensive. As a result, one-third of the public have never visited a lawyer and another one-third have visited a lawyer only once. We concluded from these facts, that easy and ready access to legal consultation, at a cost that people do not fear, would go a long way toward breaking down the barrier which seems to exist between the American public and lawyers. The central and

most important part of Prudential's Group Legal Services Plan, therefore, is our preventive legal care benefit. This benefit provides unlimited telephone access to personal legal services.

We believe that it is extremely important from a cost point of view to encourage people to seek a lawyer's advice at the earliest stage of a legal problem. Addressing a legal problem at an early stage can often avoid expensive litigation that can occur if the problem is allowed to become aggravated. Statistics being accumulated from legal services programs providing easy access to legal consultation, indicate that 80 to 85 percent of the legal questions can be resolved via telephone conversation between the plan participant and the lawyer, together with any resulting telephone calls and simple letters to third parties. This not only helps to avoid later expensive litigation costs for some of the problems, but it also screens many of the perceived legal problems from requiring unnecessary attorney office visits. This feature should help provide legal services to the public at a low cost.

For these reasons, initial consultations are a vital part of a successful group legal services plan. Qualified plans should not be required to limit these initial consultations in any way—not in duration, not in number, and not in the way in which a lawyer conducts a consultation.

EMPLOYEE CONTRIBUTIONS

Another area of concern which Senator Packwood has mentioned is excessive restrictions on employee contributions. This is also an area of great concern to us.

Code section 120 allows a qualified group legal services plan to provide personal legal services through prepayment of, or provision in advance for, legal fees in whole or in part by the employer. In spite of the statute's use of the words "or in part," the proposed regulations virtually prohibit employee contributions under qualified plans.

We believe that no limitations should be placed on employee contributions under qualified group legal services plans. Any such limitations deter the establishment of new plans and, in our opinion, serve no useful purpose. Therefore, we ask the Subcommittee to amend S. 1039 by adding a provision to make it clear that employee contributions are permitted without limit. This provisions could simply amend Code section 120 to provide that a qualified group legal services plan may, without restriction, allow an employee to make payments under the plan in any form, including contributions, premiums, copayments, and deductibles.

Prohibiting almost all employee contributions, as the current regulations do, has a direct negative impact on the cost effectiveness of qualified plans. To assure cost effectiveness, a group legal services plan should have some cost sharing between the employer and employee. As much as possible, we should avoid the problems of overusing legal services indemnified through insurance in the same way that medical services indemnified through insurance have been overused. Experience gained from group health insurance plans certainly leaves little doubt that overuse is more likely to occur when the insured employee has no financial interest in the plan.

Prohibiting employee contributions under qualified group legal services plans also ignores a very basic marketing and underwriting concept in group insurance. The fact is, the vast majority of successful group insurance benefit plans in this country involve some cost sharing between the employer and employee. In spite of the fact that many plans are paid for entirely by employers, new coverages which have been added during the past decade, such as long term disability and dental benefits, have not been paid for entirely by employers—at least not initially. With existing costs for medical services benefits increasing so rapidly, employers are most reluctant to grant additional employee benefits without some cost sharing by employees.

Prohibiting employee contributions under a qualified plan may also cause an additional problem—that of preventing an employee's dependents from being covered under the plan. For example, to preserve equity among employees, many employers adhere to non-discrimination guidelines which encourage them to administer and fund their employee benefit programs on a basis pertaining only to employment. In fact, this condition is a part of many state laws governing group life and health insurance. Consequently, although an employer may pay the entire cost of the employee's coverage because of the employment relationship, the employee may have to contribute the entire premium required to insure his dependents. Therefore, if employees cannot contribute for group legal insurance, their dependents might not become insured. Certainly, this was not intended by Congress.

For these reasons, we believe that employee contributions under qualified group legal services plans should be allowed, and should be allowed without limit.

ADDITIONAL CONCERNS

Other areas of concern mentioned by Senator Packwood also are of concern to us. One of these is excessive restrictions on the definition of "personal legal services." Essentially, the proposed regulations define a personal legal service as a legal service which does not pertain to: (i) a trade or business of the recipient; (ii) the management, conservation or preservation of property held by the recipient for the production of income; or (iii) the production or collection of income by the recipient.

Parts (ii) and (iii) of the foregoing definition seem to us to be overly restrictive. Therefore, we would support an amendment to Code section 120 to define the term "personal legal services" as legal services other than legal services primarily related to the conduct of a trade or business of an employee, his spouse, or his dependent. (As previously discussed, the term "personal legal services" should also be statutorily defined to include consultations held to determine a plan participant is in need of a legal service which may be provided under the plan.)

Another area of concern mentioned by Senator Packwood is reliance on actual utilization rates of plan benefits to determine if a plan is entitled to qualification. The proposed regulations provide for such reliance in applying both the statutory requirement of non-discrimination and the statutory limitation on contributions for shareholders. Actual utilization rates on legal services generally are fortuitous and therefore unpredictable. Thus, reliance on such rates for purposes of determining plan qualification is likely to deter the establishment of new plans, especially for small employers. Reliance on utilization rates may also result in unfair disqualification of established plans.

For these reasons, we prefer that actual utilization rates not be used in determining plan qualification. However, if such rates are to be used, we suggest that they not be taken into account until the plan has been in operation for at least three years; in many cases, utilization rates for a period of less than three years may not be indicative of a long-term pattern. Most importantly, utilization rates should not be taken into account for purposes of retroactive disqualification of a plan.

A related problem which is associated with the statutory limitation on contributions for shareholders is the fortuity of employment levels. Because of the unpredictability of employment levels, the 25 percent limitation on contributions for shareholders is likely to be a strong deterrent to the establishment of group legal services plans by small employers. For example, the plan of an employer with 16 employees, 4 of whom are in the limitation class, would be disqualified automatically if one of the other 12 employees quit. We believe that the Subcommittee should explore ways of making qualified group legal services plans a more feasible alternative for small employers, and we would be happy to work with the Subcommittee in this endeavor.

Thank you for this opportunity to present our views. We strongly support S. 1039, and we hope that the Subcommittee will also expand the bill in the ways we have suggested.

Prepared Statement by Richard Scupi, Director, UAW Legal Services Plan

Mr. Chairman, my name is Richard Scupi. I am the Director of the UAW Legal Services Plan. The UAW Legal Services Plan was the first organization to receive a 501(c)(20) ruling from the Internal Revenue Service to provide prepaid legal services. We are here to day to testify in strong support of S. 1039, which you have introduced to make permanent Section 120 of the Internal Revenue Code.

We all recognize that lawyers and the judicial system play a central role in our society. This means that in order for Americans to fully participate in their society, they must have access to lawyers and to the judicial system. Increasing awareness of this point has created significant interest in prepaid legal services as an employment fringe benefit. In 1976, Congress recognized this interest by enacting Section 120 of the Internal Revenue Code for a temporary five-year period.

Enactment of Section 120 was an important breakthrough, as it permitted unions to collectively bargain for prepaid legal services. UAW immediately seized the opportunity to establish a model prepaid legal services program. The UAW Legal Services Plan is demonstrating that a broad section of Americans—UAW members, retirees and their dependents—can be provided meaningful access to lawyers and courts at a modest cost.

The Plan is a national prepaid pilot program which provides personal legal services for most hourly UAW members who work for the Chrysler Corporation or who have retired under the UAW-Chrysler pension program and for the families of such employees and retirees. It received the first 501(c)(20) ruling from the IRS in

1978. By early 1979, the Plan was operational on a nationwide basis providing prepaid legal servcies to its Participants.

In contrast to the traditional methods of providing professional services, where the profesionals control the costs and quality of their services, the Plan's structure places cost and quality controls over professional services in the hands of people representing consumer interests.

The Plan's policy-making body is its Administrative Committee, chaired by Gabriel N. Alexander, a nationally-known arbitrator who also serves as Impartial Chairman of the Appeal Board under the UAW-Chrysler contract. The Chairman appoints three independent members to the Committee. These members are Theodore St. Antoine, a professor and former Dean at the University of Michigan Law School; Ruth Kahn, an attorney and arbitrator; and Arthur Johnson, Vice President of Wayne State University. UAW's representatives on the Committee are Homer Jolly, Assistant Director of the UAW's Chrysler Department; M. Jay Whitman, UAW Associate General Counsel; and Arthur Hughes, formerly on the UAW staff in a variety of key positions. Former members of the Committee include Marc Stepp, UAW Vice President, and John Fillion, UAW General Counsel.

Unlimited legal services for 140,000 families throughout the country could not be provided with the limited funds available to the Plan. The Plan's prepaid benefits were designed to provide comprehensive legal services for certain important legal problems and to provide either office work or referrals for most other legal problems. (A detailed statement of Plan benefits is in the "Summary Plan Description" booklet.)

Because its goal is to provide its Participants with high-quality legal services in as economical and efficient a manner as possible, the Plan maintains a high degree of control over costs and quality. One effective way of maintaining such control is through a delivery sytem where the Plan selects, employes, trains, and supervises salaried full-time attorneys, and organizes and systematizes the practice in the offices out of which these attorneys work. For this reason, the Plan relies heavily upon the staff office delivery system to provide services. Such offices have been established by the Plan throughout the country in areas where a significant concentration of eligible Participants live and work. The Plan's largest office is in Detroit (where its National Administrative offices are also located), and was established to make services available to approximately 85,000 Participants in 1978 through 30 attorneys and an equal number of support staff. The Plan's other offices are located in St. Louis, Missouri; Central Indiana (Indianapolis, Kokomo and New Castle); Belvidere, Illinois (near Rockford); Twinsburg, Ohio (near Cleveland); Perrysburg, Ohio (near Toledo); Newark, Delaware; and Syracuse, New York. About 85 percent of those eligible are provided services by attorneys out of these staff offices.

There are, however, about 15,000 employees and retirees who do not live or work near one of the Plan's offices, and who are scattered throughout 46 states. Since a staff model was not a feasible approach to providing services to these Participants, other delivery systems had to be employed. The Cooperating Attorney Program was developed to fill this need. On the basis of information obtained from a comprehensive questionnaire and discussions with individuals who have personal knowledge of an attorney's competence, performance, and reputation, the Plan has selected and contracted with several hundred private attorneys nationwide who constitute the Cooperating Attorney network. These attorneys have agreed with the Plan to provide services to Participants referred to them, to bill the Plan at specified rates for specified services, to provide the Plan with detailed reports regarding time spent, fees charged and the final result for each case, to refer any desputes between themselves and a referred Participant to the Plan for resolution, and to abide by the Plan's disposition of such matters. Participants who are referred to a local attorney after calling a central toll-free number in Detroit, are in turn encouraged to take an active role in resolving their legal matter, to contract the Plan with questions or for assistance in order to make certain that the Cooperating Attorney is providing satisfactory services, and to complete a Client Satisfaction Questionnaire. These questionnaires, along with an experimental peer review program, enable the Plan to monitor the quality of services being provided and to a take corrective action where necessary.

Some representative comments from Participants using the Plan's benefits have been:

An assembly line worker from Illinois wrote: "I think this program is a wonderful program for those of us who make too much money to qualify for the poor class and not enough to say we are rich."

A retiree from Florida said: "[I think] this is a very good thing for the retirees—they have to live on a small pension and can't afford the expense."

A Michigan worker said: "(My attorney) did one hell of a job to get my problem solved after six months of no progress. I tried the legal services and he solved my problem in one month. All my concrete was replaced above and beyond my problem because the contractor didn't want to fight him . . ."

The widow of an auto worker in Tennessee said: "It is a great blessing to retired people, in particular, who live on limited incomes."

A laid-off worker in Delaware wrote: "I think the Plan is great. We are now able to get legal advice that most of the UAW members could not afford (including me)."

A young worker from Alabama proclaimed: "I think this program will give the average member a chance to clear up small but important matters which make such a difference these days."

A Participant from California wrote: "We were very pleased with the service provided by our attorney. She kept us up to date and really was concerned about our problems * * * I think that your UAW Legal Service Plan is terrific. It has given us the opportunity to fight for our own personal legal rights and protect our home investment * * *"

When given a possible range of responses of very valuable, somewhat valuable, not very valuable, and not valuable, over 90 percent of those Participants using the Plan have stated they found the Plan very valuable.

Since one of the Plan's purposes is to develop internally a body of operating experience that will permit meaningful comparisons between different methods of providing prepaid legal services, the Plan is also experimenting with insured programs and several distinct models of arrangements with Cooperating Attorneys. In Oregon, Kentucky, and much of Pennsylvania, the Plan has contracted with a commercial insurer to provide Plan benefits.

The two years of the Plan's operations have coincided with a period of economic distress for many Plan Participants, so there has been unexpectedly heavy reliance by laid off workers upon the Plan. The Plan's existence has enabled many Participants to exercise their rights effectively when it was of great importance to them to receive legal assistance.

In a little more than two years of operation, more than 50,000 cases have been opened by the Plan for Participants. Table I demonstrates the range of problems confronting Participants for which the Plan has been able to provide assistance:

TABLE I. TYPES OF PROBLEMS PRESENTED (CUMULATIVE TO MAY 7, 1981)

Type of problem	Number of cases	Percentage of all cases
Wills, probate, tax	10,616	21
Housing, real estate	9,595	19
Consumer, debtor	12,237	24
Family matters	8,356	16
Torts	3,912	8
Criminal and traffic violations	3,936	8
Miscellaneous	1,985	4
Nonlegal	1,215	2

The cost of providing personal legal services through the delivery systems employed by the Plan are modest indeed; the Plan's expenditures for 1978–1980 are set out in Table II, below. The cost of providing benefits to each eligible family in 1981 will be about $30.

TABLE II.—UAW LEGAL SERVICES PLAN, EXPENDITURES SCHEDULE

	1978	1979	1980	Summary
Startup costs	$590,839			$590,839
National office [1]		$1,083,660	$857,133	1,940,793
Detroit office		1,255,536	1,549,625	2,805,161
Indiana offices (3)		301,968	404,105	706,073
St. Louis office		200,545	233,614	434,159
Newark, Del., offices (2)		147,558	210,316	357,874
Belvidere, Ill., office		111,853	153,794	265,647
Twinsburg, Ohio, office		119,685	150,086	269,771
Perrysburg, Ohio, office		95,688	127,203	222,891

TABLE II.—UAW LEGAL SERVICES PLAN, EXPENDITURES SCHEDULE—Continued

	1978	1979	1980	Summary
Syracuse, N.Y., office		104,420	114,713	219,133
Total operational	590,839	3,420,913	3,800,589	7,812,341
Capital outlay	200,865	462,924	43,855	707,644
Total	791,704	3,883,837	3,844,444	8,519,985

[1] This line item includes costs of providing benefits in those areas not served by a plan office as well as administrative costs.

Generally speaking, the lowest rate of usage of Plan benefits is by those who do not live or work near any of the Plan's offices, most of whom are retirees. Table III shows the distribution of cases through May 7, 1981:

Table III.—Geographical distribution of cases (cumulative to May 7, 1981)

State	*No. of cases*	*State*	*No. of cases*
Alabama	1,013	Mississippi	5
Arizona	36	Missouri	5,111
Arkansas	18	Nebraska	1
California	222	Nevada	5
Colorado	22	New Jersey	29
Delaware [1]	3,046	New Mexico	1
Florida	293	New York [1]	2,226
Georgia	40	North Carolina	3
Hawaii	1	Ohio	4,113
Idaho	1	Oklahoma	4
Illinois [1]	4,802	Oregon	33
Indiana [1]	6,459	Pennsylvania	184
Kansas	5	Rhode Island	3
Kentucky	45	South Carolina	2
Louisiana	19	Tennessee	76
Maine	1	Texas	23
Maryand [1]	924	Virginia	24
Massachusetts	11	Washington	2
Michigan [1]	23,014	West Virginia	10
Minnesota	24	Wisconsin	1
		Total	51,852

[1] States where Plan has one or more offices.

The UAW Legal Services Plan, in pursuing the goal of cost-effectiveness, has developed several characteristics in its operations. Emphasis is placed upon the use of legal and office systems, for example. This appears to be the characteristic of a law office that is most highly correlated with both efficient operations and high-quality services.

One of the Plan's goals is the acquisition of sufficient data to permit unions and employers to make informed judgments as to the type of prepaid legal services program that is most suited to their needs. The Plan has been acquiring such data for over two years now and will have preliminary results within the next year. The Plan's experience will be heavily relied upon by parties involved in collective bargaining of prepaid legal services simply because it will be available to them. Not surprisingly, "for profit" operations, such as commercial insurers and law firms, treat such data as confidential.

The operating experiences in the 1980s of differing models of prepaid legal services programs will go a long way towards determining the eventual form of prepaid legal services programs. We can be sure that employers and unions, influenced by their experience with health care, will seek to avoid the perils of provider domination and cost escalation in prepaid legal services. We can also be sure that delivery systems akin to HMOs in the health care area will have opportunities to demonstrate any advantages they have over systems relying upon fee for service arrangements based upon usual and customary fees. It may well be that the way in which lawyers have organized their profession to meet the needs of business is not well suited to meeting personal legal needs in a cost-effective manner. If so, then the way in which the group purchasing power inherent in prepaid legal services is used may

have significant effects upon the legal profession. Within the present regulatory framework, the form of prepaid legal services is properly being left to be determined by the competitive forces at work in the field.

We believe, along with UAW, that there is a great unmet need for legal services amongest American workers and their families. We are committed to a large first step in meeting that need. But we are also committed to meeting that need from a consumer's point of view. That means providing high-quality, effective legal services. In doing so, we want to solve problems without creating a whole new set of problems by building into our program cost escalations.

The early experiences of the UAW Legal Services Plan demonstrate that providing high-quality legal services in an economical manner is possible through a combination of several delivery models, each a component of a national legal services program.

We have no question that the Plan is serving a vital purpose and meeting needs that would otherwise not be met. The Plan's 501(c)(20) status and Section 120's provisions are of course indispensable to the continuation of the Plan. Since Section 120 will expire at the end of 1981 unless S. 1039 is enacted, we strongly support S. 1039.

Prepared Statement by Sandra H. Dement

BACKGROUND

The National Resource Center is pleased to have the opportunity to offer testimony in support of S. 1039, a bill which would make permanent Section 120 of the Internal Revenue Code. Section 120 excludes from employee income both the contributions to and the value of benefits received from qualified group legal services programs. Our testimony is drawn from nearly ten years of experience with legal service plans, and from our extensive information clearinghouse of nearly 20,000 plan documents.

The National Resource Center is a coalition of consumer, labor and employment organizations that has worked to improve citizen access to the justice system. We have encouraged the development of legal clinics and have pressed for recognition of the First Amendment protection to which lawyer advertising is entitled. We have promoted improved lawyer referral services, do-it-yourself law, the use of paralegals and related developments in legal service delivery. But the most important of our efforts has been to establish prepaid legal service plans as a fringe benefit of employment.

Consumer and and labor organizations have supported prepaid legal service plans for decades because they bring legal services within the reach of the average citizen. While the National Resource Center has supported the development of legal service plans for nearly ten years, the first group plans actually date from the 1930's when automobile clubs attempted to offer auto-related legal assistance. Conflict between labor and consumer groups seeking services for their members and state bar associations determined to prevent the unauthorized practice of law continued until the 1960's, when the Supreme Court issued a series of four rulings which established "meaningful access to the courts" as a First Amendment right. In the final case, *United Transportation Union* v. *Michigan State Bar,* 401 U.S. 576 (1971), Justice Black wrote:

"(T)he principle here involved cannot be limited to the facts of this case. At issue is the basic right to group legal action, a right first asserted in this Court by an association of Negroes seeking the protection of freedoms guaranteed by the Constitution. The common thread running through our decisions . . . is that collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment. However, that right would be a hollow promise if courts could deny associations of workers or others the means of enabling their members to meet the costs of legal representation." Id. at 585, 86

A decade ago, evidence was mounting that a sizable proportion of the American population was not served at all by lawyers, and that there was reason to question whether "equal justice under law" was more fiction than reality. The subsequent study of legal needs conducted by the American Bar Foundation confirmed that two-thirds of the population has unmet legal needs. Of these, half have either *never* seen a lawyer, or have seen a lawyer only *once* in their lives.

Congress itself has a record of nearly ten years in support of legal service plans. Eight years ago, Congress determined that legal service plans provided through the private sector are a desirable mechanism for increasing citizen access to the legal system, and that legal service plans are an appropriate addition to the employee compensation system. Accordingly, the Taft-Hartley Act was amended in 1973 to

allow the use of employee benefit trusts to provide legal services. Within a year the first employer-funded collectively bargained legal service plans were established. In 1974, a further step was taken when Congress included legal service plans among the employee welfare benefit plans subject to Title I of the Employee Retirement Income Security Act. ERISA created a regulatory framework that allowed legal service plans the freedom they needed to experiment and to thrive.

Congress also determined, in 1976, that legal service plans would neither develop nor grow without certain changes in the tax code to put legal plans on a more or less equal tax footing with other employee fringe benefits. Accordingly, Congress included in the 1976 Tax Reform Act a new section 120 of the Internal Revenue Code. This provision clarifies the tax status of prepaid legal service plans by providing explicitly that:

(a) Employer contributions to legal service plans on behalf of an employee did not constitute income to the employee; and

(b) The value of legal services provided under a legal service plan did not constitute income to the employee.

At the same time, Congress created Section 501(c)20 providing for tax-exempt trusts through which legal service plans could operate.

Again, in 1978, Congress acted to resolve the question whether amounts contributed to legal service plans constituted wages for the purpose of federal withholding by deciding that they did not.

Because of the experimental nature of the plans in the mid-1970's, Congress made Section 120 temporary in order to provide an opportunity to re-examine the effect of Section 120 on the plans in the light of actual experience. We are here today to determine whether the judgment of five years ago still stands, and if so, whether Section 120 should be made a permanent part of the Code. The National Resource Center strongly supports S. 1039, which would make Section 120 permanent.

A PROFILE OF OPERATING LEGAL SERVICE PLANS

Employer-funded legal service plans appear to constitute the largest and most significant category of plans. Clearinghouse documents at the National Resource Center identify employer plans covering at least a half a million persons. These plans include both collectively bargained plans and plans funded unilaterally by employers. While the collectively bargained plans range considerably in size, from fewer than 100 employees to more than 100,000, the unilateral employer plans are all small. Collectively bargained plans thus account for almost all the employees covered by employer-funded plans.

Section 302(c) of the Taft-Hartley Act stipulates that collectively bargained prepaid legal service plans may not be used to sue either the employer or the union, nor may they be used for defense of union officials charged with violations of certain federal labor statutes. Most plans are required to be jointly administered by trustees selected by the employer and the union. Legal service plans established unilaterally by employers are treated just like any other employee welfare benefit plans and must meet the reporting disclosure and filing requirements of ERISA.

Numerically, the other important category of employment-related plans are those funded unilateraly by unions. The National Resource Center's clearinghouse documents suggest that another 350,000 persons are covered by these plans. These plans are not directly affected by Section 120 since they are not employer-funded, but they are usually viewed by the unions as experimental plans that they hope to convert to employer funding in the future.

Plans exist in every region and nearly every state in the country. They are most prevalent in major metropolitan areas, especially those that are more heavily unionized.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. (Where the plans are funded by a union, job-related legal services such as defense of civil suits—against police or teachers, for example—are often also included.) Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses.

Almost all plans cover both the employee and his family. The National Resource Center files contain only one or two examples of plans which limit services to the employees. Coverage for retires is also frequently provided.

Because of the potential impact of plans on the private bar, there has been considerable interest over the years in the way in which legal services are delivered. Some years ago every discussion of plans seemed to degenerate into a debate on the relative merits of open and close panels. Today that debate has subsided. Each type has its place, and most delivery systems are either "modified" open or "modified" closed. Delivery systems are best considered as varying across a spectrum based on the degree to which a client's choice of attorney is guided or narrowed. At one end of this spectrum is one-lawyer staff or closed panel without an "opt-out provision". At the other end is the traditional legal delivery system, which provides little or no guidance in the choice of a lawyer. Closed panels make it easier for a plan member to find a suitable lawyer, they improve cost control, and they simplify quality control. Open panels allow more freedom of choice, and are the only practical delivery method for plans whose members are thinly scattered geographically. Open panels tend to narrow as a result of word of mouth advertising; closed panels tend to expand to accommodate new member groups or to provide services requiring specialists.

Closed panels presently predominate among the collectively bargained prepaid legal plans, but almost every imaginable combination of delivery systems has been used somewhere by someone. Each plan's system has to be tailored to meet the needs of the plan's members.

The cost of legal service plans has not changed much over the years. Today a plan that provides unlimited telephone advice and consultation with an attorney, some limited follow-up and reduced fees for additional services costs between $20 and $50 per family per year. A reasonably comprehensive legal service plan costs between $80 and $200 per family per year. Plans tend to provide more limited benefits initially using whatever monies are available, and then expand services gradually when more funds are available.

REVENUE LOSS ISSUES

Determining the revenue loss to the Treasury from Section 120 is difficult for two reasons. First, because revenue loss may be determined in at least two different ways. Second, because data on utilization rates and claim costs is not really available. The National Resource Center estimates revenue loss of between $7.50 and $12 per covered person. As indicated previously, the National Resource Center files show approximately a half a million individuals covered by employer-funded plans. The National Resource Center believes it is familiar with the major plans established during the past five years, but makes no claim that its files contain information about all plans. Accordingly, its best estimate is that there are between a half a million and a million people covered by legal service plans, producing an annual revenue loss of between 3.75 and 12 million annually.

The revenue loss figures were arrived at by applying a 20 percent marginal rate of taxation to the amounts estimated to be received in benefits. The lower figure was arrived at by assuming an annual utilization rate of 15 percent and an average "claim cost" of $250. The higher figure was produced by assuming an average annual utilization rate of 20 percent and an average claim cost of $300. For example, if one million people were covered by legal service plans, 200,000 legal matters would be generated annually (one million persons times a 20 percent utilization rate), at an annual average cost of $300. This would generate 60 million dollars in legal benefits (200,000 cases times $300) which would be taxable at a 20 percent rate of marginal taxation, producing an annual 12 million dollar revenue loss. On the other hand, if you assume a half million people covered, at 15 percent utilization rate, a $250 average cost and a tax rate of 20 percent, the revenue loss would be 3.75 million dollars annually.

It is also possible to estimate revenue loss by applying a 20 percent marginal rate of taxation against the amount contributed by employers to legal services funds. Revenue loss would be $8 million annually assuming 1 million people are covered, average family size is 2.5 people, and an average employer contribution is $100 per employee per year. (1,000,000 ÷ 2.5 × $100 × 20 percent).

Assuming that, in the absence of Section 120, legal services would be taxable to the individual employee, difficult problems would arise in assessing the value of these benefits, especially in the case of services which may be provided by a panel of staff attorneys who do not bill on a fee-for-service basis. Valuation problems also arise in connection with services such as paralegal assistance, marital counselling and so on. Because of the Supreme Court's decision in *Goldfarb*, we no longer have any bar association minimum fee schedules on which to base a valuation.

REGULATIONS

As you know, Congress in Section 120 wisely permitted a variety of plan structures, but enacted strict rules to assure that plans did not cover business-related legal matters and that they did not discriminate in favor of owners and highly paid employees. IRS has proposed interpretive regulations concerning some of those rules in Section 120. Their proposed regulations are unduly restrictive and would inhibit the continuing growth of plans. As an attachment to these remarks I am submitting a copy of the National Resource Center's detailed comments on these proposed regulations. We are optimistic that IRS will respond favorably to our arguments and issue final regulations that are more consistent with Section 120 and more conducive to the growth of plans than those they have proposed. For this reason we support S. 1039 rather than a more elaborate revision of Section 120. Until the final regulations appear, however, we will remain anxious. I urge this Commission to go on record in favor of regulations consistent with the purpose of the stature, and hope it will stand ready to recommend amendments to Section 120 to implement that purposes, should they prove necessary.

CONCLUSION

Legal service plans have been developing since the early 1970's. The first employer-funded legal service plans were established in 1974, after the amendment of the Taft-Hartley Act. Today, it is estimated that between 500,000 and a million families are covered by employer plans. The continued development of the plans in the private sector will depend in part on the economy and in part on the continuation of Section 120 of the Internal Revenue Code.

The National Resource Center believes that without Section 120 neither employers nor employees will have an incentive to establish such plans. Indeed, without the provision, employees would potentially face large cash tax bills as a consequence of taking advantage of plan services. Few employers or unions would be willing to negotiate legal service plans under these circumstances.

For nearly 50 years, the consumer movement and the labor movement have been working on mechanisms that would improve access to the legal system. Section 120 of the Internal Revenue Code is like the third leg on a three-legged stool. Without it, neither the *United Transportation Union* decision nor the Taft-Hartley amendment will have much meaning. Employees would be left with the right to establish such plans, but without the ability to structure plans that make economic sense.

NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES,
Washington, D.C., June 30, 1980.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.
(Attention CC:RL:T:EE-5-78)

Comments of the National Resource Center for Consumers of Legal Services Concerning Proposed Regulations §§ 1.120-1, 1.120-2 and 1.501(c)(20)-1

Who we are

The National Resource Center is a non-profit, tax exempt research and education organization incorporated in 1973 to:

Improve the quality of justice in the United States;

Conduct studies identifying the needs of consumers for legal services, and measuring the extent to which those needs are unmet by the legal services presently available;

Undertake research into the various ways that legal services are made available to the public, and to conduct carefully designed and monitored experimental and demonstration projects, to increase the quality and reduce the cost of legal services;

Design programs for the delivery of quality legal services at the lowest possible cost to consumers who are not members of an organized group;

Develop and carry out the educational programs that will make the results of the Center's research widely available to the general public;

Act as an educational clearinghouse and a public information center for matters affecting consumers of legal services;

Work with law schools, universities, colleges and junior or community colleges, and other organizations and institutions to develop educational programs and courses for legal assistants and paraprofessionals;

Develop programs for the eduction of consumers in lay advocacy; and

Develop and implement education programs of preventive law, and to educate consumers in the availability and use of legal services.

The Center's Board of Directors is made up of distinguished representatives from all dimensions of the legal service delivery field, especially from consumer and labor

groups, but also from provider organizations and the research, education and public interest communities. Our members include prepaid legal service plans, organizations sponsoring plans, legal services providers and interested individuals.

The National Resource Center is presently conducting a study of prepaid legal service plans for the Department of Labor. The Department expects to use our study as the basis for its report to Congress with respect to the desirability of continuing the exclusion from income provided in section 120.

The National Resource Center was part of the coalition that was instrumental in securing the enactment of sections 120 and 501(c)(20) of the Code in 1976. We are obviously deeply interested in seeing that the regulations promulgated under those sections do not unduly restrict the development of legal service plans.

Summary of comments

While we generally support both the thrust and wording of the regulations, we see major problems with the following:

1.120-2(a) The phrase"established and maintained" is unnecessary, inconsistent with section 120, and may lead to wholly unnecessary disputes or litigation.

1.120-2(h) This subsection appears to exclude plans requiring joint contributions by employer and employee. Such an exclusion is not authorized by statute and is indefensible on policy grounds.

1.501(c)(20)-1(c) This does not resolve the circularity of § 120(c)5(C) and the second sentence of section 501(c)(20).

Several less important points concern:

1.120-2(c)(4) Initial consultations should not be required to be limited in number or hours.

1.120-2(d)(3)&(4) Eligibility of spouses and dependents should be determined as of the time services on a particular matter were initiated.

1.120-2(g)(2) There is no reason why monthly contributions should be required rather than prepayment in some other time period.

1.120-2(c)(3) This should expressly mention services such as expert witnesses, stenographers and others not necessarily "under the direction or control of a lawyer."

1.120-2(f)(5)(ii), (iii) An "all or nothing" standard for each plan year seems harsh, inflexible and unnecessary.

Established and maintained

Subsection (a) of 1.120-2 begins, "In general, a qualified group legal services plan is a plan established and maintained by an employer * * *" The phrase "established and maintained" does not appear in the statute, and appears to have been adapted from the definition of "employee welfare benefit plan" in section 3 of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406 (ERISA). We believe the use of the phrase in the proposed regulation to be inappropriate and a sure source of future confusion and dispute, for several reasons.

First, we note that while ERISA uses "established or maintained," the proposed regulation uses "established and maintained." Was this an error? What is intended by the change?

Second, if the phrase is meant to add substantive requirements to those in section 120(b)-(d), it is illegal and invalid. If the phrase does not add anything to "separate written plan of an employer for the exclusive benefit of his employees * * *" it should be deleted as unnecessary.

Third, "established or maintained" in ERISA has been extensively litigated, commented on, interpreted, etc. within the context of federal preemption of state regulation. That context is quite different from that of the proposed regulation. The policy considerations are different. Why introduce a phrase that brings such "baggage" with it and that has proved so troublesome in its prior context, when it is not necessary to do so?

Joint contributions

Subsection (h) of the proposed regulation appears to preclude plans from being qualified plans if both the employer and employee contribute. We believe this restriction to be unauthorized by the statute, unjustified and unwise.

We find nothing in section 120 of the Code suggesting that a qualified plan may not also receive employee contributions. Section 120(a) simply states that "gross income of an employee * * * does not include—(1) amounts contributed by an employer * * * under a qualified group legal services plan * * *" Neither the definition of a qualified plan in subsection (b), nor the requirements of subsection (c), nor the special rules in (d) even hint that employee contributions may not be part of a qualified plan. Where does the Service find its authority for this important proposed restriction?

We do not understand the rationale for such a restriction. Any employee contributions are of after-tax dollars. We do not see any accounting difficulty in separating employer and employee contributions. If 100 percent employer-paid plans are permitted and receive favorable tax treatment, and if 100 percent employee-paid plans are permitted and do not receive favorable treatment, what justification is there not to permit favorable tax treatment of the employer-paid portion of a joint plan other than accounting difficulty? We see none.

It has been suggested to us that this restriction might have been transferred from the pension plan area, where there is concern about plans accumulating large amounts of money that earn substantial untaxed(?) investment income. In this case, we are told, employee contributions should not be allowed. This may be a proper concern in the pension area, where contributions are large and funds must be invested, where income on tax-deferred or tax-free contributions is the whole basis for the plan. It is most assuredly not true for legal service plans, whose purpose is to provide legal services, not to accumulate money or make it grow. If a legal plan finds itself with a surplus, it either reduces future contributions or expands benefits. The way we interpret ERISA, the fiduciaries of a legal plan must either expand benefits or reduce contributions whenever it becomes apparent that an unneeded surplus is accumulating.

Prohibiting joint contribution plans is unwise. The whole purpose of section 120 was to expand the availability of legal services to families, to encourage employees to seek legal counsel, to assist them in managing their affairs, asserting their rights and resolving disputes. The section was also meant to encourage innovation in legal services delivery. To prohibit joint contribution plans goes quite against these statutory purposes. As economic growth inevitably slows and inflation continues, more and more employers are providing fringe benefits on a joint contribution basis. This may be because employers can no longer afford to pay the full cost of such expensive fringes as medical benefits, or because they prefer not to pay the cost unless the employees find the benefit sufficiently valuable to be willing to pay part of the cost with after-tax money. In any case, joint contribution is increasingly popular, quite sensible, and, with respect to legal service plans, entirely consistent with section 120 of the Code.

(c)(20) Trusts

Proposed regulation 1.50(c)(20)-1 does not explain, much less resolve, the apparent circularity of sections 501(c)(20) and 120(c)(5)(C) that has caused considerable confusion. Probably only Congress can resolve the problem, but the proposed regulation certainly ought to recognize it. We simply do not understand 1.501(c)(20)-1(c). Perhaps examples in the regulation itself or in the preamble would suffice.

The following excerpts from an article by the former executive director of the National Resource Center published in our journal last fall, show the context in which we have attempted to evaluate this subsection of the proposed regulation.

"The new exempt organizations section for prepaid legal services plans was created partly because of the continuing struggle and confusion over the proper activities of § 501(c)(9) funds and partly because the technical staff of the Joint Committee on Internal Revenue Taxation was not in favor of the concept of prepaid legal services and wanted at least to segregate legal services funds and to subject them to a number of special requirements. Regulations defining other benefits have been pending since 1969; while efforts were made to resolve the problem through the Tax Reform Act in favor of including non-legal benefits as a proper purpose of § 501(c)(9), the controversy surrounding the attempt resulted in a decision not to disturb the delicate balance of the dispute. Accordingly, in a colloquy on the Senate floor, Senator Long and Senator Packwood, the bill's sponsor, exchanged these remarks:

" 'Mr. PACKWOOD. I would like to clarify two things. First, it is my understanding that the amendment dealing with group prepaid legal services plans, which creates a new exempt organization or trust, is not intended to create any inference with regard to whether other types of organization belonging to another category of exempt organizations under § 501(c) are permitted to fund or provide group prepaid legal services plans.

" 'I ask the chairman, is my understanding correct that no inference is to be drawn with regard to other organizations from the creation of this new category of exempt organizations?

" 'Mr. LONG. The Senator is correct. The amendment avoids taking any position with regard to what are proper activities for any type of exempt organization, whether it be a charitable institution, a union, a professional association, or a social club. Any question about whether exempt organizations, other than the new type created in § 501(c)(20), are allowed to be involved with group prepaid legal services plans is not affected by this legislation. If there is a dispute about this question, it

should be resolved by the ordinary administrative and judicial procedures available to both taxpayers and the Internal Revenue Service.

" 'Mr. PACKWOOD. Therefore, if I understand the chairman, the creation of § 501(c)(20) should not be interpreted as either supporting or denying the claim of certain bar associations or certain social welfare funds that they may fund or provide tax-exempt group legal services benefits. Rather, whether or not such organizations are permitted to be involved with group prepaid legal services plans should be determined under existing law.

" 'Mr. LONG. The Senator from Oregon is correct.' "

The provision in its entirety reads as follows:

"(20) an organization or trust created or organized in the United States, the exclusive function of which is to form part of a qualified group legal services plan or plans, within the meaning of § 120. An organization or trust which receives contributions because of § 120(c)(5)(C) shall not be prevented from qualifying as an organization described in § 501(c)(20) merely because it provides legal services or indemnification against the cost of legal services unassociated with a qualified group legal services plan."

The cross reference to § 120 is of course crucial, for that is the section which defines what a qualified group legal services plans is. Briefly, to be considered a qualified group legal service plan, a plan must be a separate written plan of an employer for the exclusive benefit of his employees, their spouses and dependents, providing personal legal services, and subject to certain notice and antidiscrimination provisions, as well as certain provisions pertaining to classes of eligible providers under the plans. Those provisions, contained in § 120(c)(5), are as follows:

(5) Contributions.—Amounts contributed under the plan shall be paid only (A) to insurance companies, or to organizations or persons that provide personal legal services, or indemnification against the cost of personal legal services, in exchange for a prepayment or payment of a premium, (B) to organizations or trusts described in § 501(c)(20), (C) to organizations described in § 501(C) which are permitted by that section to receive payments from an employer for support of one or more qualified group legal services plan or plans, except that such organizations shall pay or credit the contribution to an organization or trust described in § 501(c)(20), (D) as prepayments to providers of legal services under the plan, or (E) a combination of the above.

Prepaid legal services plans differ substantially from health care plans in that there are a wide range of providers available. In addition to self-administered legal services plans run by groups themselves, prepaid legal services may be offered by: bar associations; life, casualty and mutual insurance companies; a joint venture of the two; Blue Cross and Blue Shield corporations or their subsidiaries; private entrepreneurial firms, both profit and non-profit; and law firms. In the normal course of things, an employer and a union would, pursuant to a collective bargaining agreement, establish a 501(c)(20) trust which is authorized to receive amounts contributed under the plan by § 120(c)(5)(B). Most of these funds apply for a 501(c)(9) exemption if they are providing health benefits, a 501(c)(17) if they are providing supplemental unemployment benefits, a 501(c)(18) if they are providing a pension, and so forth. Section 501(c)(20) says nothing about how the trust itself must spend its funds to provide services; presumably it can contract with any kind of profit or non-profit entity, and can also provide services directly through salaried staff lawyers. Where the employer is funding the program directly, amounts contributed under the plan can be paid over "as prepayments to providers of legal services under the plan" (i.e., to lawyers or law firms) under § 120(c)(5)(D) or directly to an insurance company under 120(c)(5)(A), as well as through a trust which seeks a 501(c)(20) exemption under 120(c)(5)(B).

Two questions arise in connection with the 501(c)(20) exemption. One is whether bar-sponsored prepaid legal services plans are entitled to receive a 501(c)(20) exemption. The question must be answered with reference to section 501(c)(20) primarily. While section 120 permits employers to pay contributions to "organizations * * * that provide personal legal services or indemnification against the cost of personal legal service", such as bar associations, it does not affect the narrow language of 501(c)(20). That section speaks of an organization or trust "the exclusive function of which is to form part of a qualified group legal service plan or plans, within the meaning of § 120" (emphasis added).

This raises the question of what was meant by the second sentence of 501(c)(20). The answer to the question whether bar association plans will ultimately secure exempt status depends on the meaning of the second sentence.

The motivation of the drafters in adding the second sentence of the section was to be sure that bar association-sponsored plans which offered to non-employment groups as well as employment groups were not barred from becoming exempt under

501(c)(20) "merely because it provides legal services * * * unassociated with a qualified group legal services plan." The specific situation which was brought to their attention was the provision of legal services to the poor by bar plans under contract to the Legal Services Corporation. However, the reference to the receipt of contributions because of section 120(c)(5)(C), which in turn refers to employer contributions, appears to create a meaningless circularity. In this writer's opinion, the reference to 120(c)(5)(C) is a technical error and should have referred to 120(c)(5) in its entirety. The provision was intended to mean that a 501(c)(20) trust which receives employer funds will not lose its exemption if it also receives some monies from a 501(c)(3) or other exempt 501(c) organization. But the reference to "payments from an employer" drastically narrows the provision.

Three other possible meanings were offered by Marvin Lazarus in a recent article. He suggests either that the language has no purpose and the "Congress only intended to accompish a vain and pointless act", that it is "a result of the technical staff's unfamiliarity with group legal plans," or that it represents "a last ditch effort to restrict exclusions and exemptions wherever possible." In connection with the last point he offers an explanation which seeks "to give some reality to this new language:"

"The argument is that not all of the organizations under 501(c) lend themselves to receiving employer contributions. One has only to point to a custodial corporation under § 501(c)(2), or a humane society under § 501(c)(3). It may well be argued, therefore, that the phrase in question means that qualified group legal plans are to be restricted to those organizations under 501(c), the mechanics of which lend themselves to receiving employer contributions. Such organizations which receive, or by their nature could receive, employer contributions for a legitimate purpose would be authorized not to create group legal plans, per se, but merely to act as a conduit to channel money through to a 501(c)(20) organization. If this point of view were adopted, clearly there would be no need for IRS to expand the meaning of 'other benefits' in 501(c)(9) nor give a blank check to other organizations to expand fringe benefits under their general 501(c) authority, since they could only operate a legal plan through a (c)(20) organization."

If this point of view were adopted, clearly there would be no need for IRS to expand the meaning of "other benefits" in 501(c)(9) nor give a blank check to other organizations to expand fringe benefits under their general 501(c) authority, since they could only operate a legal plan through a (c)(20) organization."

Initial consultations

Proposed subsection 1.20-2(c)(4) would require initial consultations to be limited either in time or number. We do not see why this limitation is required in order to restrict a qualified plan's services to personal legal matters. A client-employee can not be expected to know precisely what is a personal legal service and what is not. A plan attorney can not know until he is consulted about the matter. The proposed subsection provides that initial consultations must not include document preparation or review, or representation. With these restrictions it appears redundant to require that initial consultations be restricted in number or time. Nor does the proposal prevent a plan from simply setting very high limits.

One of the fastest growing types of prepaid plans provides unlimited telephone consultations, follow-up letters and phone calls, and referrals were required to panel attorneys who have agreed to provide further services at discount rates. These plans cost about $30 a family a year. They are popular because they put legal advice just a phone call away, with no limits, no strings, no paperwork. While most of these plans are subscriber-paid, not employer-paid, we do not see any justification for preventing these plans from being picked up by employers.

Eligibility of spouses and dependents

Subsection (d)(3) says that "In general . . . the determination of whether an individual is a spouse of an employee is made at the time the legal services are provided to the individual." This should be changed to make the determination at the time the first services are rendered on a particular matter. Once a plan attorney has begun handling a case he should be allowed to continue. Having a cutoff date after which the attorney must cease work on a case, or after which the client must begin paying can be very prejudicial to the outcome of that case.

Many plans now operating provide for continuing services on cases already begun for the duration of the case. Others have a one year cutoff. We see no reason why these plans should have to alter their rules or else cease to be qualified plans.

Subsection (h), discussed above, does not take care of this problem. Many plans do not have any provision for employee, spouse or dependent contributions, and, in any case, that subsection does not permit contributions by spouses who become former

spouses, or dependents who cease to be such under section 152, while a legal matter is pending.

Monthly payments

Subsection (g)(2) appears to require monthly contributions. We do not see why it is necessary to restrict contributions in this way. Why should employers not be able to make bi-weekly or quarterly contributions? Monthly contributions appear to be most comon, but the statutory requirement of prepayment in no way mandates this particular accounting period.

Legal services

Paragraph (c)(3) appears intended to cover everything normally considered a "legal expense." To remove doubt, however, we suggest that "expert witness" be added to the list of examples in subparagraph (ii). Such witnesses may not be considered by some people to be "under the direction or control" of the lawyer hiring them.

Under subparagraph (iv) it might be helpful to mention such incidental expenses as printing or long distance phone calls. How separately these are broken out in a lawyer's billing should not affect their eligibility for payment by a qualified plan.

All or nothing standard

Subsection (f) of 1.120-2 is long and complex, and not of much importance, we believe, to any plans with which we're familiar. The 25 percent rule simply is not a factor. We are a bit concerned about the "all or nothing" nature of plan qualification. Either a plan is a qualified plan under section 120 or it isn't. Either all the contributions may be excluded, or none of them. Because of the many detailed requirements for becoming and remaining a qualified plan, it would seem useful to have some graduated system of penalties, perhaps like the excess business income provisions for some tax-exempt organizations. Graduated penalties would make it easier for the Service to enforce all its requirements, and would lessen the burden of uncertainty on plan administrators. It may be that such a change requires amendment of section 120 itself, but the restriction in (f)(3)(i) would seem to require very elaborate safeguards and accounting controls in order for even a large plan to be secure against violating the 25 percent rule at some point early in a plan year.

Hearing request

We request a hearing to present our views on the above points in a setting permitting better dialogue than the Federal Register. These regulations are important to the future of prepaid legal service plans.

Respectfully submitted,

WILLIAM A. BOLGER, *Attorney*.

Senator PACKWOOD. I am going to switch the order just slightly and take two bills that are of concern to Senator Matsunaga. First, we will take S. 450 and then S. 230.

Tad, if you want to come up we will start on S. 450 with Mr. Richard Rolapp and Tad Davis. Oh, and George Smathers is here. Good.

Senator, good to see you again.

Senator SMATHERS. Thank you, I am glad to be here.

Senator PACKWOOD. Good morning, Tad.

Mr. Rolapp, do you want to start?

STATEMENTS OF JAMES ROLAPP, PRESIDENT, AMERICAN HORSE COUNCIL; THOMAS A. DAVIS; AND GEORGE SMATHERS, FORMER SENATOR AND MEMBER OF THE FINANCE COMITTEE

Mr. ROLAPP. Mr. Chairman, my name is Richard Rolapp. I am President of the American Horse Council. As you have noted, I have with me today former Senator George Smathers who is our general counsel and I believe also a former member of the Senate Finance Committee, and Thomas A. Davis of the law firm of Davis and McCloud in Washington, D. C.

The American Horse Council appreciates very much this opportunity to express our views on S. 450, a bill which would make up to $100,000 of a taxpayer's annual investment in breeding and work horses eligible for the investment tax credit.

We are here on behalf of this Nation's 3.25 million horse owners and breeders to express our very strong support for legislation that would make horses eligible for this credit.

A reason, in part, is based on fairness. All livestock except horses are presently eligible for the investment tax credit. Denial of the tax credit for investment in horses is inconsistent with the fact that investment in horses, like investments in other productive assets, makes significant contributions to our economy.

The breeding, training, racing and showing of horses is a very labor-intensive business. Farms engaged in breeding horses for the race track employed 80,000 people in 1980, alone.

There were 145,000 persons employed on breeding farms engaged in raising show animals last year. There are 350,000 people licensed to work at race tracks and another 231,000 work during horse shows. There are additional tens of thousands of people employed in support and allied industries.

You may be interested to know that there are approximately 8.2 million horses in the United States today according to the U.S. Department of Agriculture. They play an integral part in present-day agriculture.

Our industry infuses billions of dollars into the agricultural economy. In 1980, hay, straw, oats, and other agricultural products valued at $4.5 billion were used by horses. Horses are the single largest consumer of oats grown in the United States and the production of hay and other crops represents a significant income source for farmers.

The horse industry contributes favorably to the balance of trade for the United States. Exports during 1980 came to over $200 million. Much of this is because we are breeding in this country today the highest quality of horses of almost every breed to be found anywhere in the world and our horses are in great demand by horse owners in foreign countries.

In 1980, horse racing produced nearly $70 million in direct parimutuel taxes in the 30 States which have legal horserace wagering.

Racing also produced more than $1 billion in Federal, State, and local taxes.

Horse shows in 1979 contributed $27 million to charitable organizations, plus local admission taxes and Federal, State, and local payroll taxes.

Given all these economic facts, and there are many more I could point to, we see no reason why the Internal Revenue Code should discriminate against horses and no other form of livestock.

In addition to ending an inequitable exclusion, providing investment tax credit for horses would produce significant benefits. Many racetracks suffer at the present time from a shortage of animals which results in smaller fields in their races. Figures clearly demonstrate that smaller fields result in less interest from the patron and thus, fewer wagers.

This results in diminished wagering at the racetrack and corresponding loss of revenue for the track, the horse owners, and the States which have racing.

If a racing horse is eligible for investment credit there would be new incentive for production of moderate-priced horses which are needed to sustain all kinds of competitive events.

As you know, Mr. Chairman, in 1978 the Senate adopted an amendment making breeding horses eligible for the credit. Unfortunately the amendment was not adopted by the conference committee. But during consideration of that amendment, the Treasury Department agreed that there was no policy reason for denying the credit to the purchase of horses.

We recognize that it may be appropriate to limit the amount of credit which could be claimed on the purchase of a single horse. Thus, we would support a provision such as the one contained in S. 450, which would provide that only the first $100,000 of the cost with respect to one horse would qualify for the credit.

The per horse limitation would limit the total amount of credit to $10,000 in cases where horses acquired by a syndicate or a partnership as well as in cases where a horse is acquired by an individual.

Such a limitation would provide a strong incentive for the production of more racing and showing stock in the price range where these incentives are most needed.

We also suggest that the committee consider extending the investment credit to all horses used in the trade or business, not just to breeding or workhorses.

Since introduction of this bill, many horsemen around the country have commented that investment in other types of horses, such as race horses and show horses, also has favorable economic effects and that the $100,000 per horse limitation would be adequate to prevent any windfalls.

Again, we appreciate very much this opportunity to testify and I would also like to thank Senator Matsunaga, who has introduced this legislation along with Senators Boren, Ford, and Huddleston.

Senator PACKWOOD. Thank you very much. Senator Smathers, do you have any comments?

Senator SMATHERS. Thank you, Mr. Chairman. The only thing that I would state is that I don't think there is any logical, equitable, or economic reason for not giving to all horses the same benefit of investment tax credit which you do to other livestock. Other than that I can't add any more.

Senator PACKWOOD. I agree with you. You know that logic is not necessarily the driving force of legislation.

Senator SMATHERS. Unfortunately, that is the case.

Senator PACKWOOD. Tad.

Mr. DAVIS. Senator, I would just add to make it clear, I think sometimes the understanding is that we are giving the tax credit for hobbies or recreation and that is not the case. We are giving a tax credit for the animal that produces those horses which probably will not be eligible for the tax credit.

We are talking about giving some credit to the machinery which produces the product and I do think in deference to Senator Mat-

sunaga's original bill, we originally had in mind doing it only for breeding horses.

Since then, there have been a variety of different changes in the policies that are being put forward by the White House and we have some concern by those people out in the hinterlands about why we are doing just for that one particular type of horse.

If I go out and put an animal on the race track for 5 years and I am spending the money and producing the jobs at the race track, aren't I doing the same thing if I'm in the business of horses? That is one of the things that we have not been able to fully go through with Senator Matsunaga, but we would like to do that as we proceed with the legislation.

Senator PACKWOOD. Senator Matsunaga.

Senator MATSUNAGA. To answer the question raised by the witnesses as to why race horse, as well as show horses are not included. Well, because of the prejudice against racing and gambling. I thought this might be a foot in the door. But, I do sense, as you witnesses have, there has been a change in attitude toward race horses and show horses recently.

I would be more than happy to accept an amendment to include all horses rather than just working and breeding horses and see whether members of the committee would accept such a proposal.

Mr. Chairman, I have a prepared statement which was intended to be offered as an opening statement and I ask that it be included in the hearing record as an opening statement.

Senator PACKWOOD. It will be put in as an opening statement ahead of the testimony.

PREPARED STATEMENT OF SENATOR SPARK M. MATSUNAGA

Mr. Chairman and Members of the Committee, the bill under consideration, S. 230, would permit the voluntary withholding of State income tax from seamen's wages.

The Internal Revenue Code permits an employer to withhold Federal taxes, but the employer is forbidden from withholding any State income tax.

Section 601 of Title 46 of the United States Code forbids an employer from withholding State income tax from seamen's wages. This provision is intended to prevent seamen engaged in interstate commerce from being victimized when several States seek to tax, and have their taxes withheld from, seamen's wages.

This provision, however, makes no sense when applied to seamen who work on ships that ply only between ports in one and the same State, and who voluntarily request their employer to withhold their State income tax. To cite a case in point, in Hawaii, pineapples are transported on barges from plantations on the neighboring islands to the canneries in Honolulu on the island of Oahu. Seamen employed on these barges sail only between Hawaiian ports, and are in no danger of being taxed by two or more States. For their own convenience, these Hawaiian seamen have asked their employers to withhold their Hawaii State Income Tax, but their employers are barred by the Statute from doing so.

Consequently, these seamen, and their employers, are faced with additional administrative burdens since they must file quarterly estimated income tax returns and overcome cash budgeting problems.

My bill, S. 230, seeks to correct this situation by authorizing the employer of a seaman employed in trade between ports in one and the same State to withhold the state income tax from the seaman's wages, strictly on a voluntary and revocable basis, at the request of the seaman.

I introduced the bill at the request of the State Governor and with the support of the employers and seamen's union involved. I believe this legislation, which in no way violates the intent of the United States Code, will prove of benefit to all concerned. it deserves the favorable consideration of this Committee.

Thank you very much.

Senator MATSUNAGA. I might point out, Mr. Chairman, that an amendment which I offered at the Finance Committee, I believe you were present at that time, which provided similar provisions of S. 450 was adopted by the Finance Committee and passed by the Senate.

Unfortunately, in the rush hours of the closing session, we lost it in conference, but it is not a matter which this committee has not considered before, nor the Senate has considered before. So, I urge the favorable report on S. 450.

Senator PACKWOOD. Thank you, Senator Matsunaga.

Gentlemen, thank you for coming.

Mr. ROLAPP. Thank you very much.

[Prepared statements of the preceding panel follow:]

PREPARED STATEMENT OF AMERICAN HORSE COUNCIL, INC.

SUMMARY

The American Horse Council, Inc. ("AHC") strongly supports S. 450, a bill which would make up to $100,000 of a taxpayer's annual investment in breeding and work horses eligible for the investment tax credit.

There is no sound policy reason for the rule in plresent law under which investment in horses is not eligible for the investment tax credit but investment in other livestock is eligible. Denial of the investment tax credit for investment in horses is inconsistent with the fact that investment in horses, like investment in other productive assets, makes significant contributions to our economy.

S. 450 provides that only $100,000 of the investment in any one horse is eligible for the investment tax credit. AHC believes that this limitation is appropriate. However, AHC suggests that the Committee consider extending the investment tax credit to all horses used in a trade or business, not just breding or work horses. Since introduction of the bill, many have observed that investment in other types of horses, such as race horses and show horses, has favorable economic effects. Also, if the per hourse limitation discussed above is retained, the $100,000 of investment "per taxpayer" limitation need not be retained. Furthermore, AHC believes that if provisions extending the investment tax credit to horses are made a part of a broader cost recovery bill, these provisions should be retroactive to the same extent that other changes in depreciation and the investment tax credit are retroactive.

STATEMENT

The American Horse Council, Inc. ("AHC") appreciates this opportunity to express its views on S. 450, a bill which would make up to $100,000 of a taxpayer's annual investment in breeding and work horses eligible for the investment tax credit.

AHC strongly supports legislation to make horses eligible for the investment tax credit, which currently applies to all other livestock.

The Council is a trade association which represents over 140 bred registries and horse-related organizations, as well as thousands of individual horsemen.

Investment in horses benefits the economy

All livestock except horses are presently eligible for the investment tax credit. Denial of the investment tax credit for investment in horses is inconsistent with the fact that investment in horses, like investment in other productive assets, makes significant contributions to our economy. Breeding, training, racing and showing horses are very labor intensive businesses. Farms engaged in breeding horses for the race track employed 80,000 people in 1980 to produce approximately 50,000 foals. Similarly, the breeding of horses for shows also involved a high ratio of employees. Although figures for the showing industry are less accessible, it is estimated there are 145,000 persons employed on breeding farms engaged in raising show animals last year.

The breeding and raising of horses is only a portion of the total employment generated by the horse industry. There are 350,000 people licensed to work at race tracks, and another 231,000 work during horse shows. These figures include only those people working directly iln the racing and showing industries. There are additional tens of thousands employed in support industries.

The 8.2 million horses in the United States play an integral part in present day agriculture and the industry infuses billions of dollars into the agricultural econo-

my. In 1980, hay, straw, oats and other agricultural products valued at $4.5 billion were used by horses. Horses are the single largest consumers of oats grown in the U.S., and the production of hay and other crops represents a significant income source for farmers.

While horses are used for recreational purposes, or are involved in competitions in this country, exports during 1980 came to over $200 million, contributing to the vital export balance generated by American agriculture. Much of the export trade results from the dominance of the U.S. blood stock industry. Recognizing the quality of the horses produced in this country, foreign buyers have played an increasing role in the sale of quality American blood stock.

It should also be noted that horse farms make an important contribution to the quality of life in America. Many breeding farms are located on the fringe of urban areas and the economic structure of horse breeding is capable of supporting these operations on land which would otherwise be under severe development pressure. Thus, the existence of these farms helps to preserve important open space adjacent to major population centers.

Horses also make substantial financial contributions to society. Horse racing produced nearly $700 million in direct parimutuel taxes in the 30 states which have legal horse race wagering. Racing also produced more than $1 billion in Federal, State and local taxes. Horse shows in 1979 contributed $27 million to charitable organizations plus local admission taxes and Federal, State and local payroll taxes.

Problems with present law

We see no reason why the Internal Revenue Code should discriminate against horses and no other form of livestock. No reason was given in the legislative history as to why horses were excluded from eligibility for investment as tangible property used as an integral part of a farming business when other livestock were made eligible for the credit in 1971.

In addition to ending an inequitable exclusion, providing investment tax credit for horses would produce significant benefits. Although prices for top quality yearlings and breeding stock have increased during the past few years, there has not been a corresponding rise in demand for moderate quality horses, despite a growing demand for both show and racing animals. Many race tracks suffer at the present time from a shortage of horses, which results in smaller fields in their races. Figures clearly demonstrate that smaller fields result in less bettor interest and, thus, fewer wagers. This results in diminished wagering at the track and a corresponding loss of revenue for the track, horse owners and the States which have racing. By making horses eligible for investment credit, there would be a new incentive for the production of the moderate priced horses which are needed to sustain all kinds of competitive events.

Support for S. 450

The American Horse Council, Inc. ("AHC") strongly supports S. 450, a bill which would make up to $100,000 of a taxpayer's annual investment in breeding and work horses eligible for the investment tax credit. We applaud Senators Matsunaga, Boren, Huddleston, and Ford for sponsoring this bill.

In 1978, the Senate adopted an amendment making breeding horses eligible for the credit. Unfortunately the amendment was not adopted by the conference committee. During consideration of that amendment, the Treasury Department agreed that there was no policy reason for denying the credit on the purchase of horses.

AHC recognizes that it may be appropriate to limit the amount of credit which could be claimed with respect to a single horse. Thus the AHC would support a provision, such as the one contained in S. 450, which would provide that only the first $100,000 of cost with respect to one horse would qualify for the credit. This "per horse" limitation would limit the total amount of credit to $10,000 in cases where a horse is acquired by a syndicate or partnership—as well as in cases where a horse is acquired by an individual. Such a limitation would provide a strong incentive for the production of more racing and showing stock in the price range where such incentives are most needed.

AHC suggests that the Committee also consider extending the investment tax credit to all horses used in a trade or business, not just breeding or work horses. Since introduction of the bill, many horsemen around the country have commented that investment in other types of horses, such as race horses and show horses, also has favorable economic effects and the $100,000 "per horse" limitation is adequate to prevent windfalls. Also, if the per horse limitation discussed above is retained, the $100,000 of investment "per taxpayer" limitation need not be retained. Furthermore, AHC believes that if provisions extending the investment tax credit to horses

are made a part of a broader cost recovery bill, these provisions could be retroactive to the same extent that other changes in depreciation and the investment tax credit are retroactive.

AHC very much appreciates the opportunity to testify on this matter.

Senator PACKWOOD. Next, we have S. 230, another bill introduced by Senator Matsunaga. As I understand it, Senator Matsunaga, you will speak on behalf of this bill as there are no witnesses?

Senator MATSUNAGA. No witnesses.

Senator PACKWOOD. Do you have a statement?

Senator MATSUNAGA. Yes. Mr. Chairman, the bill under consideration, S. 230, would permit the voluntary withholding of State income tax from seamen's wages.

The Internal Revenue Code permits an employer to withhold Federal taxes but the employer is forbidden from withholding any State income tax.

Section 601 of title 46 of the United States Code forbids an employer from withholding State income tax from seamen's wages. This provision is intended to prevent seamen engaged in interstate commerce from being victimized when several States seek to tax and have the taxes withheld from seamen's wages.

This provision, however, makes no sense when applied to seamen who work on ships that ply only between ports in one and the same State and who voluntarily request the employer to withhold their State income tax.

To cite a case in point, in Hawaii pineapples are transported on barges from plantations on the neighboring islands to the canneries in Honolulu on the island of Oahu. Seamen employed on these barges sail only between Hawaiian ports and are in no danger of being taxed by two or more States. For their own convenience, these Hawaiian seamen have asked the employers to withhold their Hawaii State income tax from their wages but the employers are barred by the statute from doing so.

Consequently, these seamen and the employers are faced with additional administrative burden since they must file quarterly estimated income tax returns and overcome cash budgeting problems.

My bill, S. 230, seeks to correct this situation by authorizing the employer of a seaman employed in trade between ports in one and the same State to withhold the State income tax from the seaman's wages strictly on a voluntary and recoverable basis at the request of the seaman.

I introduced the bill at the request of the State Governor and with the support of the employers and seamen's unions involved.

I believe this legislation, which in no way violates the intent of the United States Code, will prove of benefit to all concerned. It deserves the favorable consideration of this committee.

Thank you very much.

Senator PACKWOOD. It is not often that we have a bill to which there is no objection, but I have heard of no objection to this bill at all.

Let's move on to S. 644 and we have Mr. James Riddell speaking on behalf of Dial Corp.

STATEMENT OF JAMES W. RIDDELL, REPRESENTING THE DIAL FINANCE CO. OF DES MOINES, IOWA

Mr. RIDDELL. Mr. Chairman, I am Dick Riddell. I appear on behalf of the Dial Finance Co. of Des Moines, Iowa.

This bill is identical to a bill, S. 2396, that was supported by the Senate Finance Committee last year and passed in the Senate and failed in the last day of Congress because of an objection that no hearings had been held there on it in the House.

The bill, last year, was supported by the Treasury Department and we believe it is this year. It was drafted by the joint committee.

From its inception, the Internal Revenue Code has contained provisions known as the personal holding company provisions which are designed to prevent an individual from incorporating his pocketbook with respect to passive income.

However, these provisions have always contained exceptions for the active conduct and trade of business which generated, ordinarily, so-called passive income such as interest, rents, royalties, and dividends.

The provision that this bill would change is the exception provided for financial institutions of consumer loans. The specific provision that needs to be changed is that that requires a company to qualify to accept with the exception, to derive more than 60 percent of its income from loans having maturity of 60 months or less.

Changes in the business have extended maturities far beyond 60 months and if this bill is adopted to change the definition, it will be the fifth time since the provision was first added to the Internal Revenue Code that it has been changed by changing business conditions.

I would ask that my statement be included in the record and what I have done is summarize in my summary.

Senator PACKWOOD. Your full statement will be in the record. This is a case that this committee is well familiar with and justice and equity is on your side.

Mr. RIDDELL. Thank you, Senator.

If there are any questions, I will be happy to answer them.

Senator PACKWOOD. I have no questions. I recall when as you say we lost this on the last day of the session, we passed it and I had my fingers crossed that we were going to get it. You have my support again.

Mr. RIDDELL. Thank you.

Senator PACKWOOD. Senator Matsunaga.

Senator MATSUNAGA. Mr. Chairman, I might inquire whether the hearings have been held in the House this year.

Mr. RIDDELL. No. The bill has been introduced in the House. As you may know, the chairman of the Subcommittee on Miscellaneous Revenue Bills has been very, very ill and the committee has been devoting its major attention to other matters.

However, an acting chairman has been appointed and he has been assured by the chairman of the Committee on Ways and Means that an opportunity for such bills, including this one, will be short——

Senator MATSUNAGA. Well, that will resolve the problem you ran into last time then.

Mr. RIDDELL. Yes, as a matter of fact it was very interesting. I don't think that this bill, or the subject matter of any of the bills were really an issue. It appears that, at the time, one of the gentlemen, now a very, very important one, was greatly concerned about the prerogatives of the House.

Senator PACKWOOD. That is why Senator Matsunaga's question is very valid. If the House has a hearing that will by and large take care of any question and then if we add it in conference they will not raise the argument, that it has had no hearing in the House.

Mr. RIDDELL. Yes, sir. Thank you.

Senator PACKWOOD. Thank you very much.

[The prepared statement of Mr. Riddell follows:]

PREPARED STATEMENT OF JAMES W. RIDDELL

SUMMARY

Mr. Chairman, I am James W. Riddell, a member of the law firm of Dawson, Riddell, Fox, Holroyd and Wilson, Washington, D.C. and I am appearing today on behalf of Dial Corporation in support of S. 644. I have submitted a formal statement for the record, which, with the Committee's permission, I will summarize here today.

Dial Corporation, headquartered in Des Moines, Iowa, is predominantely a consumer finance company extending credit in numerous forms both to consumers and to commercial operations. It is estimated that approximately 2000 financial companies need the protection of S. 644.

S. 644 is identical to S. 2396, which was introduced in the last Congress and was supported by the Treasury Department. That bill passed the Senate in the last Congress as a part of H.R. 7117, but was not considered by the House due to procedural problems on the last day of the Session. An identical measure, H.R. 2397, has also been introduced in the House by Congressman Holland.

The Bill updates the present Internal Revenue Code definition of a "personal holding company" as it relates to the definition of "personal holding company income" for lending and finance corporations. The personal holding company provisions, which have been in the Code for many years, are designed to tax "passive income" earned by certain closely-held corporations. The Congress, as well as the Treasury, has consistently recognized that those companies, even though closely held, which engage in the active conduct of the lending and finance business were not to be penalized by reason of the personal holding company provisions. Therefore, specific exceptions have been written into the law. Beginning in 1938, exceptions were created for the active conduct of the finance business. From time to time, as the method of operation of the industry has changed, Congress has updated these provisions of the Code to reflect the new method. Such action was taken in 1950, 1962 and 1964.

Currently, the form of operation and type of loan made by consumer finance companies is becoming more concentrated in "home equity loans" and "manufactured home" (mobile home) financing, generally having maturities of up to 12 years and in revolving credit, also known as open-end credit, which has no stated maturity. It is to accommodate these changes in loan maturities which now exist and will increase in the future that S. 644 seeks to amend existing law. This is not a new exception and will create no revenue loss. The provision merely updates present law and allows all companies in the industry to compete on an equal basis.

Present law imposes a tax of seventy percent on the undistributed income of a personal holding company (Sec. 541-547). A personal holding company is defined as a corporation, sixty percent (60 percent) of the adjusted ordinary gross income of which is personal holding company income (generally passive investment income), and fifty percent (50 percent) of the stock of which is owned by five or fewer persons. Certain types of companies whose active business involves the investment of funds and the earning of interest and dividends (i.e., normally passive income is income not from the active conduct of a business), are exempted from the personal holding company definition.

In order to meet the requirements for the finance and lending company exemption, a finance company, among the requirements, must earn 60 percent or more of its income from loans which have an average maturity of less than 60 months. It is this 60-month maturity requirement which has failed to reflect the dynamic changes in the finance industry in recent years.

The trend in personal loans is toward larger loans with longer maturities, and, in the case of the rapidly expanding revolving or open-end credit, with no fixed maturity at all in the traditional sense. According to statistics developed by the Federal Reserve Board, the percentage of personal loans having a maturity of over 42 months increased from a negligible amount in 1972 to 26.4 percent of loans made in 1977. The 1977 figure almost doubles the percentage of higher maturity loans from the year before.

Additional data on consumer finance transactions compiled by the First National Bank of Chicago indicates that the percentage of loans written for longer than 37 months (the only category including over 60-month loans) grew from 11.76 percent in 1972 to 20.35 percent in 1977 to 30 percent in 1978.

This data reflects not only the increase in numbers of longer maturity loans but the rapidity with which the numbers of such loans are increasing. It may be expected that, particularly with the tremendous increase in the volume of second mortgage loans (almost all of which have maturities of at least 60 months or longer), the strength of the trend will continue.

S. 644 will amend Section 542 of the Internal Revenue Code in two respects. First, section 542(d)(1)(B)(i) will be amended by replacing the 60-month maturity limitation with a limitation of 144 months. Additionally, the bill will except from the computation of average maturities all open-end or revolving credit transactions (indeterminate credit) as that term is defined in the Truth in Lending Act.

The second amendment will also tighten the eligibility rules for consumer finance company exclusion from the definition of "personal holding company." Subsection (c) of Section 542 excepts a number of business enterprises from the definition of personal holding company. Paragraph (6) of that subsection provides for the exclusion of certain lending or finance companies if certain conditions are met. Among those conditions is the requirement that the sum of deductions which are directly allocable to the finance business must exceed the sum of 15 percent of the first $500,000 of ordinary gross income from the finance business, plus 5 percent of the second $500,000 of gross income from the finance business.

At the request of the Joint Committee on Taxation, S. 644 will extend the amount to which the 5 percent applies from $500,000 to the total amount of all gross income derived from the finance business which exceeds $500,000. The result will be that overall percentage of deductions directly attributable to gross income from the finance business must be greater than under present law in order for a consumer finance company to qualify for exclusion under the personal holding company provisions.

Conclusion

S. 644, therefore, represents a balance between the need to accommodate a changing business environment and the need to insure that the exception is not employed as a device to avoid the personal holding company rules. We respectfully urge expeditious and favorable consideration of this legislation. Thank you for this opportunity to appear before you today.

STATEMENT

Mr. Chairman, I am James W. Riddell, a member of the law firm of Dawson, Riddell, Fox, Holroyd and Wilson, Washington, D.C. and I am appearing today on behalf of Dial Corporation in support of S. 644.

Dial Corporation, headquartered in Des Moines, Iowa is predominantely a consumer finance company extending credit in numerous forms both to consumers and commercial operations. It is estimated that approximately 2000 financial companies need the protection of S. 644.

S. 644 updates the present Internal Revenue Code definition of a "personal holding company" as it relates to "personal holding company income" for lending and finance corporations. The personal holding company provisions, which have been in the Code for many years, are designed to tax "passive income" earned by certain closely-held corporations. The Congress, as well as the Treasury, has consistently recognized that those companies, even though closely held, which engage in the active conduct of the lending and finance business were not to be penalized by reason of the personal holding company provisions and, therefore, specific exceptions have been written into the law. Beginning in 1938, exceptions were created for the active conduct of the finance business. From time to time, as the method of operation of the industry has changed, Congress has updated these provisions of the Code to reflect the then-existing practice. Such action was taken in 1950, 1962 and 1964.

Currently, the form of operation and type of loan made by consumer finance companies is becoming more concentrated in "home equity loans" and "manufac-

tured home" (mobile home) financing, generally having maturities of up to 12 years and in revolving credit, also known as open-end credit, which has no stated maturity. It is to accommodate these changes in loan maturities which now exist and will increase in the future that S. 644 seeks to amend existing law. This is not a new exception and will create no revenue loss. The provision merely updates present law and allows all companies in the industry to compete on an equal basis.

An identical bill (S. 2396) was introduced in the last Congress and was supported by the Treasury Department in testimony before this Subcommittee. That bill passed the Senate in the last Congress as a part of H.R. 7117. Regretably, due to procedural problems, Congress adjourned before action could be taken in the House. Identical legislation, H.R. 2397, has been introduced in the House by Congressman Holland.

Present law

Present law imposes a tax of seventy percent on the undistributed income of a personal holding company (Sec. 541-547). A personal holding company is defined as a corporation, sixty percent (60 percent) of the adjusted ordinary gross income of which is personal holding company income (generally passive investment income), and fifty percent (50 percent) of the stock of which is owned by five or fewer persons. Certain types of companies whose active business involves the investment of funds and the earning of interest and dividends (i.e., normally passive income is income not from the active conduct of a business), are excluded from the personal holding company provisions.

Among the businesses excluded from the definition of a personal holding company are certain consumer finance companies (Sec. 542(c)(6)). Among the types of consumer finance companies intended to be excluded are licensed personal finance companies operating under the small loan (Russell Sage) laws of the various states, lending companies (not of the Russell Sage type) engaged in the consumer finance business, Morris plan banks, and finance companies engaged in the business of factoring inventories, accounts receivable, and otherwise financing the short-term and intermediate-term needs of business.

In order to meet the requirements for the finance and lending company exemption, a finance company, inter alia, must earn 60 percent or more of its income from loans which have an average maturity of less than 60 months. It is this 60-month maturity requirement which has failed to reflect the dynamic changes in the finance industry in recent years.

Historical background

While the tests to be met in order to enjoy the exclusion are the same, regardless of the type of finance company involved, this has not always been the case; and, it was as the result of Congressional attempts to simplify the various earlier exclusions that the present 60-month limitation inappropriately became a rule of general application.

The exeption from the application of personal holding company rules to licensed personal finance companies was added to the Internal Revenue laws by the Revenue Act of 1938. The exception was added to grant exemption for companies operating in the various states under statutes similar to the Uniform Small Loan Act drafted by the Russell Sage Foundation. These statutes have typically been referred to as Russell Sage laws. Under these state laws, interest could not be payable in advance or compounded and could be computed only on unpaid balances. Furthermore, the laws limited the principal amount of the loan (usually to less than $500), the term (usually less than 3 years) and the amount of interest (usually less than 3 percent a month).

The provision contained in the tax law attempted to mirror these general state requirements, rather than being more strict, as a means of insuring that the exception generally reflected the active business practices which it was designed to except. As the result, when the circumstances of the consumer lending business have rendered the tax requirements more strict than state regulatory provisions, the tax provisions have been altered as well. The primary example of this reflective action is the change effected in the provision in 1962.[1]

Prior to 1962, the personal finance company exception mirrored the earlier restrictive provisions of Russell Sage laws. The conditions for exceptions under the law at that time required that a finance company must:

1. Be authorized to engage in the small loan business under one or more state statutes providing for the direct regulation of such business;

[1] It should be noted that in 1950, an exception was added to permit interest on business loans to be computed by the "dollar add on" method to reflect changes in the law of almost one-half of the states permitting such loans.

2. Derive 80 percent or more of their gross income from lawful interest, discount, or other authorized charges;

3. Derive the 80 percent of their income, referred to above, from loans maturing in not more than 36 months made to individuals in accordance with the provisions of applicable state law;

4. Derive this 80 percent of their income from loans where the interest and all other authorized charges do not exceed the amount equal to simple interest computed at the rate of 3 percent per month not payable in advance and only on unpaid balances;

5. Derive 60 percent of their gross income from lawful interest, discount, other lawful authorized charges received from individuals whose indebtedness to the company does not exceed the limit prescribed by the applicable state law, or, if there is no such limit, $500;

6. Have trade or business expenses deductions (other than compensation for personal services rendered by shareholders or members of their family) equal to 15 percent or more of their gross income;

7. Have outstanding loans with respect to any person who is a shareholder having a 10-percent interest in the stock of the company (including stock owned by members of the family) of not in excess of $5,000.

Recognizing that the requirements no longer reflected the then-existing state statutory limits, but were more strict, Congress, in the 1962 legislation, deleted the three percent interest requirement entirely, deleted entirely the 36-month loan limit, and increased the limit on maximum amounts for loans from $500 to $1500. The legislative history of these changes as contained in the Report of the Senate Committee on Finance is instructive (in pertinent part):

"This bill omits this 3-percent-simple-interest requirement entirely, on the grounds that the personal holding company tax is not intended as a means of regulating the lending companies, but rather as a tax applicable in certain cases, to passive investments. In any event, this is an ineffectual regulatory device since this restriction applies only to about 10 percent of the outstanding small loans that are made by widely held finance companies, and therefore not treated as personal holding companies since they do not have five or fewer stockholders owning more than 50 percent of their stock. Moreover, even the companies presently subject to this restriction need to meet it only with respect to 80 percent of their gross income.

* * * * * * *

"The bill also deletes the requirement that these lending companies derive most of their income from loans maturing in not more than 36 months. Several States already have gone beyond this as a permissive period for loans and it appears likely that in the near future a number of additional States may extend maturities to more than 36 months. Your committee agrees with the House committee that it should not impose a requirement substantially more restrictive in nature than the State laws regulating this type of lending company.

"A third change made by the House bill modifies the maximum size of a loan which may qualify under the 80-percent-income requirement where there is no State law governing the maximum size of a loan. Under present law where there is not such limit under State law, a limitation of $500 is provided. Under the bill this limitation is increased to $1,500. It is understood that the only State which does not have a ceiling of its own is the State of California. When the $500 limit provided by present law was considered, this represented the usual ceiling among the States. The States have changed these ceilings materially, however, with the result that today relatively few States have a ceiling of $500 or less and in these cases there usually is provision for supplementary loans which exceeds this ceiling in certain situations. The $1,500,000 provided by this bill, where there is no applicable State limitation, today is substantially in conformance with the ceilings applicable in those States providing their own maximums.

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"A fifth change relates to the use of the term 'small loan business,' which represents the type of business in which a lending company must be engaged in order to be removed from application of the personal holding company tax under this exception. The bill adds after the term 'small loan businesses' the term '(consumer finance business)'. This is intended to make it clear that this exception is not limited to small loans in the narrow sense, but rather is intended to encompass consumer finance loans generally. Moreover, the reference to consumer finance business will bring this exception more directly in accord with the terminology now used by a number of State legislatures which have retitled the applicable provisions governing these institutions as 'consumer finance laws' as a means of providing a

more descriptive title for the type of business involved. S. Rep. No. 2047, 87th Cong., 2d Sess. (1962), reprinted in [1962] U.S. Code Cong. & Ad. News 2825, 2827-2828."

An equally compelling policy reason for eliminating tax requirements which are more restrictive than requirements of the various state laws was expressed by then-Assistant Secretary of the Treasury, Stanley Surrey, in his comments to the Senate Committee on the proposed revisions:

"It has been the Department's consistent position that taxpayers in like situations should be subject to the same rules and rates of taxation. The effectiveness of our self-assessing system to a large extent depends upon each taxpayer's willing compliance with laws which are regarded as rational and fair. Since [the small loan provisions] selects only a portion of the small loan industry for regulation, and since that portion is similar to other businesses not subject to these rules, the Department has no objection to the removal of the 3-percent-a-month and 36-month regulatory limits. S. Rep. No. 2047, 87th Cong., 2d Sess. (1962), reprinted in [1962] U.S. Code Cong. & Ad. News 2825, 2830-31."

While the 1962 legislation vastly improved the equity of the tax treatment accorded closely-held finance companies, the provision, as amended, remained extremely complex. As the result, in the Revenue Act of 1964, Congress simplified the exception by imposing one set of standards upon all types of finance companies. In so doing, a limitation on the term of loans for consumer finance companies found its way back into the law.

Subsequent to the revisions made by the 1962 Act, there remained four different types of personal finance companies which were excluded from the personal holding company category:

"1. Licensed personal finance companies, 80 percent of whose gross income is interest from loans if at least 60 percent of their gross income is received from loans classified as "small loans" by State law (or $500 if there is not State law limit) and if the interest is not payable in advance computed only on unpaid balances. In addition, loans to a person who is a 10-percent shareholder must not exceed $5,000 in principal amount. These frequently are known as "Russell Sage" type personal finance companies.

"2. Other lending companies engaged in the small loan or consumer finance business, 80 percent of whose gross income consists of interest or similar charges on loans to individuals and income from 80-percent-owned subsidiaries which in turn themselves meet this test. In addition, at least 60 percent of the company's income must be from interest or similar charges made in accordance with small loan or consumer finance laws to individuals where the loans do not exceed the State specification for small loans (or if there is no such limit, $1,500) and if the trade or business expenses of the company represent 15 percent or more of the company's gross income. These companies also must not have loans outstanding to shareholders, with a 10-percent interest or more, which exceed $5,000.

"3. A loan or investment company (such as a Morris Plan bank), a substantial part of whose business consists of receiving funds not subject to check and evidenced by certificates of indebtedness or investment, and making loans and discounts. Here also loans to a person who is a 10-percent shareholder may not exceed $5,000 in principal amount.

"4. A finance company actively engaged in purchasing or discounting accounts or notes receivable, or installment obligations, or in making loans secured by any of these or by tangible personal property, if at least 80 percent of its gross income is derived from such business. In addition, at least 60 percent of such a company's gross income must be derived from certain categories of income. These categories, in general, relate to business or factoring-type loans: such as purchasing or discounting accounts or notes receivable, or installment obligations arising out of the sale of goods or services by the borrower in his business; making loans for not more than 36 months to businesses where the amounts are secured by accounts or notes receivable or installment obligations of the type described above, or secured by warehouse receipts, bills of lading, inventories, chattel mortgages on property used in the borrower's trade or business, etc. In the case of these companies, the trade or business expenses deductions must represent at least 15 percent of the gross income of the company, and loans to those who are 10-percent shareholders in such company must not exceed $5,000 in principal amount."

It should be noted that the only type of finance company upon which a maturity limit was imposed was a finance company engaged in purchasing or discounting accounts or notes receivable, or installment obligations, or in making loans secured by any of these or by tangible property. Such factoring-type companies were required to earn at least 60 percent of their income from, inter alia, loans to businesses for not more than 36 months, where the loans arose out of the borrowers trade or business.

Curiously, when the Congress "simplified" the exception in the 1964 Act, the limit was written to have precisely the opposite effect. As the result of the 1964 Act, the 36-month limit was expanded to 60 months, but rather than applying to loans by factoring-type companies, the limit, now cantained in Sec. 542(d)(1)(B)(i) was written to apply to all but such factoring-type loans.

It is important to note that if the word "unless" in Sec. 542(d)(1)(B)(i) were changed to the word "if," the new law would have accomplished the simplification result without resurrecting a limit previously deleted as too restrictive. That simplification was the intent of the 1964 changes and that the same policy underlying the deletion of the 36-month limit was to be retained is clearly reflected in the House Committee Report:

"In the interest of simplification, your committee concluded that it would be desirable to have one exclusion available for all four of these categories of lending or finance companies. At the same time, it saw no need for purposes of the personal holding company provision to restrict the type of loans which these companies could make. This is properly a matter of regulation by State law governing these lending or finance businesses. Moreover, it was recognized that in any event the personal holding provisions do not apply to widely held corporations. In such cases only State law governs the type of loans which can be made. H. Rep. No. 749, 88th Cong. 2d Sess. (1964), reprinted in [1964] U.S. CODE CONG. & AD NEWS 1313, 1389-1390."

In the absence of an explicit explanation in the legislative history of the inclusion of a 60-month limit, one might conclude that Congress merely painted with too broad a brush when it simplified prior law. However, in light of the total reversal of the type of company to which it was to be applied and the reiteration of the policy underlying the original deletion, it is far more plausible to conclude that the 60-month limitation of present laws does not reflect legislative policy, but rather inadvertent error.

Reasons for change

Whether the result of error or generalization, the 60-month limit needlessly restricts closely-held consumer finance companies from competing on an equal basis with more widely-held companies in rapidly expanding areas of consumer finance.

As previously stated, the limitation on the term of loans was deleted because the lending and maturity restrictions under most State laws had become far more liberal than the federal tax provision. That is even more the case today. Most consumer finance companies presently operate, not only under Small Loan laws, but also under generally applicable second mortgage, usury, industrial loan and similar laws. In almost all instances, the general usury law imposes no maximum maturity. This expansion beyond small loan laws has resulted from fundamental changes in the competitive structure of the entire finance industry. Rather than competing for small loans, the bulk of recent market expansion has been in the areas of revolving credit and second mortgage loans. In the case of revolving credit, the loans have no fixed maturity. In the case of second mortgage and manufactured home loans, probably owing to the size of the loan, the maturities typically equal or exceed 60 months. (Generally, up to 12 years (144 months)).

The trend in personal loans is definitely toward longer maturities, and, in the case of the rapidly expanding revolving or open-end credit, no fixed maturity at all in the traditional sense. According to statistics developed by the Federal Reserve Board, the percentage of personal loans having a maturity of over 42 months increased from a negligible amount in 1972 to 26.4 percent of loans made in 1977. The 1977 figure almost doubles the percentage of higher maturity loans from the year before.

Additional data on consumer finance transactions compiled by the First National Bank of Chicago reflects that the percentage of loans written for longer than 37 months (the only category including over 60-month loans) grew from 11.76 percent in 1972 to 20.35 percent in 1977 to 30 percent in 1978.

This data reflects not only the increase in numbers of longer maturity loans but the rapidity with which the numbers of such loans are increasing. It may be expected that, particularly with the tremendous increase in the volume of second mortgage loans (almost all of which have maturities of at least 60 months or longer), the strength of the trend will continue.

S. 644

S. 644 will amend section 542 of the Internal Revenue Code in two respects. First, section 542(d)(1)(B)(i) will be amended by replacing the 60-month maturity limitation with a limitation of 144 months. Additionally, the bill will except from the computation of average maturities all open-end or revolving credit transactions (indeterminate credit) as that term is defined in the Truth in Lending Act.

The second amendment will tighten the eligibility rules for the consumer finance company exclusion from the definition of "personal holding company." Section (c) of section 542 excepts a number of business enterprises from the definition of a "personal holding company." Paragraph (6) of that subsection provides for the exclusion of certain lending or finance companies if certain conditions are met. Among those conditions is the requirement that the sum of deductions which are directly allocable to the finance business must exceed the sum of 15 percent of the first $500,000 of ordinary gross income from the finance business, plus 5 percent of the second $500,000 of gross income from the finance business.

At the request of the Joint Committee on Taxation, S. 644 will extend the amount to which the 5 percent applies from $500,000 to the total amount of all gross income derived from the finance business which exceeds $500,000. The result will be that overall percentage of deductions directly attributable to gross income from the finance business must be greater than under present law in order for a consumer finance company to qualify for exclusion under the personal holding company provisions.

Conclusion

S. 644, therefore, represents a balance between the need to accommodate a changing business environment and the need to insure that the exception is not employed as a device to avoid the personal holding company rules. We respectfully urge expeditious and favorable consideration of this legislation.

Senator PACKWOOD. Thank you very much for coming.

The last bill we have is S. 798, introduced by Senator Danforth and I believe there are no witnesses to testify for or against this bill.

That will conclude our hearings for the day.

Senator MATSUNAGA. Thank you, Mr. Chairman.

Senator PACKWOOD. Thank you, Senator Matsunaga, for coming.

[Hearing adjourned at 10:35 a.m.]

[By direction of the chairman the following communications were made a part of the hearing record:]

U.S. DEPARTMENT OF LABOR,
LABOR-MANAGEMENT SERVICES ADMINISTRATION,
Washington, D.C., May 21, 1981.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for information on prepaid legal service plans for your upcoming hearings. As you are aware, section 2134(d) of the Tax Reform Act of 1976 (Public Law 94-55) required the Secretaries of Labor and Treasury to report on continuation of the exclusion from income for certain prepaid legal service plans under section 120 of the Internal Revenue Code of 1954. In order to obtain information for that report the Department of Labor contracted with the National Resource Center for Consumers of Legal Services. The Center has recently submitted a preliminary draft of its findings under that contract, including data on the number and types of plans.

While, like most preliminary drafts, this draft requires further work before it is accepted by the Department of Labor, we believe the preliminary data provided in the report may be of use to your Subcommittee in its deliberations. Accordingly, we are enclosing the two chapters of the preliminary draft that provide the data.

We hope this data is helpful. We would like to reiterate that this draft represents only the contractor's preliminary submission and has not been fully evaluated by the Department. Further in submitting the draft to you, the Department is not taking any position on the merits of either extending or not extending the section 120 exclusion.

We would be happy to provide whatever further assistance you may require.

Sincerely,

IAN D. LANOFF,
Administrator, Pension and Welfare Benefit Programs.

Enclosure.

[Draft]

Prepaid Legal Service Plans in the Employment Context: A Report of Major Characteristics and Tax and Regulatory Issues

Chapter 1: Introduction

1.1 Purpose and scope of the study

Legal service plans are a new type of benefit provided in the context of employment as well as to members of non-employment groups such as consumer cooperatives and student organizations. They provide personal legal services, or reimbursement for such services, to employees or members of groups.

In the space of a few years, prepaid legal services have become an increasingly popular employee fringe benefit. A wide variety of unions in every sector of the economy have expressed an interest in prepaid legal services. Pioneered in the construction industry by the Laborers' International Union and rapidly followed by plans for municipal employers, legal service plans of every size and description have been established in every part of the country.

An apparent impetus to this development was the passage of the Tax Reform Act of 1976 which provided employer-funded plans with favorable income tax treatment. The Tax Reform Act of 1976 added section 120 to the Internal Revenue Code, granting an exclusion from employee gross income for both amounts contributed to legal service funds by an employer on behalf of his employees, as well as the value of legal services benefits received by employees.

Other significant federal legislation which impacts legal service plans is the Employee Retirement Income Security Act of 1974 (ERISA). Prepaid legal plans which are subject to ERISA were made subject to its reporting and disclosure provisions and to fiduciary standards.

By the Tax Reform Act of 1976, both the Secretaries of the Treasury and Labor are required to conduct by 1980 for the President and the Congress "a complete study and investigation with respect to the desirability and feasibility of continuing the exclusion from income of certain prepaid groups legal services benefits. . . ."

This study of prepaid legal service plans had been conducted under contract to the Department of Labor during the period 1978-1980. It provides the first statistically reliable profile of plans that are subject to either the Employee Retirement Income Security Act (ERISA) or to Section 120 of the Internal Revenue Code.

This study has been conducted in order to achieve two principal objectives. The first is to provide a basis for determining whether the mandates of the Employee Retirement Income Security Act are being fulfilled with respect to legal service plans, particularly whether the present provisions of the Act and its administration are adequate to ensure the healthy development and operation of the plans and their compliance with disclosure, fiduciary and other standards of the Act. The second objective is to provide a portion of the data base necessary for the study and investigation mandated by Congress in connection with Section 120 of the Internal Revenue Code.

Accordingly, while the universe of legal service plans includes many types of plans, the study population has been defined to cover principally those plans subject to the Employee Retirement Income Security Act, and those plans funded by employers and therefore subject to recognition under Section 120. Additionally, the study population includes those bona fide group prepaid legal service plans, presently funded by individual contributions, which appear to offer the potential for conversion to the status of a plan subject to ERISA or to Section 120.

The methodology involved in the construction of the study population is described in detail in Appendix A. Briefly, the study population was defined to include plans having all of the following characteristics:

The plan is established, maintained or funded by a group, such that the group sponsors, collects funds, administers, or performs some function in connection with the plan;

The group associated with the plan is employment-related, consisting of either an employer, an employee association, or some other employment-related organization; and

The plan involves prepayment of services.

A list was compiled of those plans in existence as of June 1979 which clearly met or might potentially meet the profile of plans relevant to the study. Non-conforming plans were excluded from the list. Table 1.1 illustrates the decision track involved in

the selection of plans in the study population. The first filter, group identification, is not shown.

TABLE 1.1.—TYPES OF PLANS INCLUDED IN THE STUDY POPULATION

Plan types	Prepaid	Source of funding for plan			Subject to—		Included in study population
		Individual	Employee Association	Employer	ERISA [1]	Sec. 120	
Group advice/referral	N		X				No.
Consumer cooperatives, student groups, etc.	Y	X or	X				No.
Nonemployment groups	Y	X or	X				No.
Individual enrollment employment groups.	Y	X					Yes, because of the potential for conversion to ER funding, and because of the inclusion of contributory plans endorsed by employers.
Credit union groups serving particular employers.	Y	X					Yes, because of potential for conversion to employer funding.
Employee associaiton plan (dues or general revenue).	Y		X		X		Yes, because subject to ERISA.
Employer-funded plans, collective bargaining (private sector).	Y			X	X	X	Yes, because subject to ERISA and Internal Revenue Code section 120.
Employer-funded pland, collective bargaining (public sector).	Y			X		X	Yes, because subject to Internal Revenue Code section 120.
Employer-funded plans, unilateral.	Y			X	X	X	Yes, because subject to ERISA and Internal Revenue Code section 120.

[1] ERISA Employee Retirement Income Security Act.

A list of approximately 2700 plans potentially subject to the study was compiled from a variety of sources, including the records of the U.S. Department of Labor, the files of the National Resource Center for Consumers of Legal Services, and filings made with agencies of state governments. This list of 2700 is by definition a subset of the total universe of all legal service plans, since no effort was made to include those group advice and referral plans, consumer plans, and other non-employment groups that could readily be identified as such. Additionally, of course, no claim is made that the search process identified every single plan potentially subject to the study. (See Appendix A for details.)

After cleaning for duplicate plans, plans no longer in existence, plans declining to participate in the study, and those for whom telephone numbers could not be obtained, a telephone screen was administered to a list of approximately 1600 plans. Of the 1328 completed telephone surveys (and 82 percent response), 266 plans were identified as qualifying for the study population. The majority of those not qualified are believed to be non-prepaid plans, the so-called group advice and referral plans. The group of 266 prepaid plans constitutes the study population.

The study population is characterized by a substantial number of "clustered plans". These are groups of similar plans marketed and administered by a single organization, provided through a number of separate, employment-related groups. Mail questionnaires for these groups often were sent to the central administrator for response. (More detail is provided in Appendix A.) In order to minimize respondent burden, administrators for the larger clusters were permitted to return a single mail questionnaire containing aggregated responses. (Individual plan data covering source of funding, size, retiree and spousal eligibility were obtained for each plan in the study population through the telephone survey.) Table 1.2 describes the configuration of respondent plans. Data for the study is drawn from both the telephone questionnaire (266 cases) and the mail questionnaire (covering 191 cases).

TABLE 1.2 DISTRIBUTION OF SINGLE AND CLUSTERED RESPONDENTS

← 191 Cases Covered by Mail Questionnaires →			
← 85 Mail Questionnaires →			
45	40	106	75
Single Mail Respondents	Clustered Mail Respondents	Clustered Teleph. Respondents	Single Teleph. Respondents
← Study Population: 266 cases →			

Difficulties were encountered at each step in the survey as a consequence of the extraordinary variety among plans and the absence of a uniform terminology to characterize their differences, and some reluctance on the part of respondents to report on their plans. In addition, plans experienced difficulty in categorizing their structures; interviewers experienced difficulty evaluating answers given them and coders experienced similar difficulties. After survey data had been gathered, coded and data entered by the research subcontractor, examination of the directory by legal service plan experts revealed the omission of certain large, well-known plans. Consequently, for certain tabulations and cross-tabulations of key variables, data values for eight "found" plans were added to the data gathered from the study population and manually recalculated.

1.2 Research objectives

The study of prepaid legal service plans has yielded two concrete products. The first is a directory tape of all plans in the United States which have been identified as meeting the study profile. The directory contains a list of the names and addresses of all currently operating plans provided in the context of the employment relationship. It is organized by state and also contains information on the number of persons covered by each plan.

The study's major product is this descriptive report based on a statistically reliable survey of plans. It profiles the major characteristics of plans and analyzes both the federal income tax consequences and the regulatory issues associated with their continued growth.

The profile will describe plans in terms of the following characteristics: Size, source of funding or sponsorship, legal service benefits, delivery system, eligibility requirements, plan costs, utilization of benefits, grievance systems.

More specifically, the study attempts to address some of the following broad questions:

Regulatory analysis

1. How many legal service plans are presently subject to ERISA, what are their characteristics, and how many persons are covered by these plans?

(a) Are there operational or structural characteristics of prepaid legal plans that would warrant reevaluation of the regulatory requirements of ERISA as they presently apply to such plans?

(b) What benefits patterns characterize prepaid legal plans? Which employees are covered? Is coverage provided to spouses and dependents, retirees or other classes of persons?

(c) Are there substantial cost differences associated with different delivery systems.

2. What is the proportion of plans established by employee associations as compared with plans established by employers (unilaterally or through collective bargaining)? Are there differences between employer and employee funded plans that have consequences for regulation?

3. Do plans subject to ERISA have claim and grievance systems as the Act requires? Are the present filing and reporting requirements of ERISA adequate and do they seem to be complied with?

Tax analysis

1. How many employer-funded prepaid legal service plans are there and what is the date of establishment of each plan?

2. How many employees are covered by employer-funded prepaid legal service plans?

(a) What proportion of plans extend services of spouses and dependents of employees?

(b) What proportion of plans extend services to retired employees?

(c) What proportion of plans extend services to officers, directors or shareholders?

3. What is the average cost per person (contribution) of the employer-funded plans?

4. What services are routinely provided under such plans?

1.3 A Definition of Major Plan Variables

The most important variable of stratification for the study is source of funding since categorization by funding type more clearly defines plans in the study which are subject to ERISA or to Section 120. But, as indicated earlier, there is a continuum of funding possibilities and it is not always easy to classify the different funding sources. For example, a credit union may receive an annual lump sum contribution from an employer to defray costs of maintaining an individual enrollment legal service plan for credit union members. A plan that has employer funding may also have employee contributions. (This seems relatively rare in legal services, since the total amount of money involved in an annual legal services "premium" or contribution is relatively small.)

The basic funding types are described below:

Types	Definitions
Employer-funded through collective bargaining	Full or partial funding of the plan by the employer or group of employers as the result of a collective bargaining agreement.
Unilaterally employer-funded	Full or partial funding of the plan is provided by the employer or a group of employers as an unbargained fringe benefit of employment.
Union or employee association dues-funded	Funding of the legal service plan by a union or employee association from membership dues.
General union or employee association funded	Funding of the legal services plan by the union or employee association from any source, except membership dues.
Individual employee-funded	Funding or partial funding of their enrollment in the plan by individual employees.

The principal distinction between the dues funded plans and those funded out of general revenues is the use in dues plans of a per capita, earmarked payment assessed equally against all members or employees of the group. In the individual payment plans, the individual must decide to enroll in order to participate, but he need not do so.

All of the funding mechanisms are group funding mechanisms. The first four could be characterized as "true group" plans, where every member is automatically covered by the plan. Funding is either from a third party (such as the employer or the union) or from payments made automatically by all members (dues). The individual payment plans could be called "association group" plans, and are primarily distinguished by the voluntary character of enrollment and payment.

Two other stratification variables of less importance require some explanation. One is benefit structure. There have been a number of approaches taken on the structuring of legal services benefits. Generally, the different structure in legal services reflect the same issues that the health care sector has debated in recent years. These include the effect on cost and quality control of the use of schedules of services and copayments; direct service versus indemnity benefits; and other similar issues. In legal services, limitations on attorney time are an additional technique of control.

With the expectation that legal service plans will one day be widely in operation, the use of benefit structures as one of the variables of stratification may provide baseline data useful in future studies of inflation or distortion in legal services costs or service utilization. Such studies, now being conducted in the health care sector, will likely shape the development of public policy toward legal service plans and may directly affect the direction of plan development.

Below is a description of the benefit structures commonly in use in the legal services field:

Types	Definitions
Hour bank	The plan provides a certain number of cases or hours of attorney time per year which may be used on any legal service or specified types of legal services.
Fee schedule	The plan provides a list of specific legal services (fees schedules), each of which may be covered fully or partially.

Types	Definitions
Shreveport plan	The plan divides covered benefits into several major service activity categories (such as advice and consultation, office work, court representation) and provides coverage for each of these service categories fully or with dollar or hourly limitations.
Group advice/referral	The plan provides mainly group and consultation with other legal services provided at reduced fees.

The first structure, the hour bank, is unique to the legal services field, and has its closest analogy in the relative value schedules in use in the medical sector. The second benefit structure, the fee schedule, is commonly in use in the benefits field. The third, named after the first legal service plan to be established, has also been widely imitated. The fourth category represents a version of the group advice and referral plan, but one which requires a substantial prepayment and provides a sufficient level of benefits to justify its being classed as a prepaid plan.

Finally, the issue of delivery system requires some discussion. Respondent plans were asked which of the following delivery systems described their plan:

Open panel.—Services are provided either (1) by any attorney chosen by the plan member, or (2) by an attorney(s) who participates on a panel sponsored by a bar association, or (3) by an attorney(s) who agrees to participate on a panel open to any attorney.

Closed panel.—Services are provided by individual attorneys, a law firm, or several law firms which are selected by the plan.

Staff panel.—Services are provided by an attorney or staff attorneys who are hired by the plan.

These categories necessarily contain some arbitrariness since plan delivery systems describe a continuum rather than falling inevitably into discrete clusters. A closed panel plan in which the number of firms is large begins to resemble the open panel plan which does not have widespread participation by the bar. Still, respondents seemed to have no difficulty in characterizing their plans in one of the three primary delivery system categories.

In the profile of plans which follows in Chapter Two plans are characterized by these three main variables which demarcate the areas of funding, benefits, and service delivery.

[Draft]

Chapter 2: A Profile of Operating Legal Service Plans

This chapter provides a profile of the legal service plans in existence as of June, 1979. The sections following describe various aspects of the structure and operation of plans. In this description the statistical measures which are primarily used are those of central tendency and frequency of distribution. The profile analyzes the following basic descriptors: Number and distribution of plans, size of plan, delivery system, benefit structure, types of benefits, eligibility for plan coverage, age and utilization experience of plans, and plan costs.

2.1 Number and distribution of plans

The study population consists of 266 plans carefully screened to ensure that subject plans met the study's operational definition of a plan. the study population is known to be a subset of the universe of plans. However, there are also two known sources of undercounting in the number of plans in the study population. One is that insurance plans are underrepresented (see Appendix A, Research Methodology, for more detail). Between 75-90 additional plans would be subject to the study had the principal insurer participated in the study and these insurance plans had been included.

A second source of undercounting (which is also reported in Appendix A) was the inability of interviewers to secure telephone numbers for 21.5 percent of the potential eligible plans in the master plan list. These plans were therefore dropped from the study. However, if telephone numbers had been secured, and if the screening calls yielded plans eligible for the survey in the same proportion as those which were found to be eligible, it is estimated that an additional 89 plans might have been found. Nevertheless, while there is no basis for believing that the inaccessible plans differed in any substantial respect from the accessible plans, such a calculation remains speculative.

Considering the missing insurance plans (probably at least 75 cases) and the plans not reached by telephone (estimated at 89 cases), the study population of 266 plans could be expanded as follows:

Confirmed plans in study population	266
Plans omitted in error—referred to as "found" plans	8
Insurance plans	75
Plans for which telephone numbers could not be found	89
Estimated plans in universe	438

If these estimates of plans in the universe which fit the operational definition of plan are reliable, the population would consist of slightly more than 60 percent of the estimated number of existing plans.

Table 2.1 describes the geographic distribution of the 266 plans (plus the 8 "found" plans) and the number of persons reported covered in each state. (The number of persons reported covered in each state represents only those plans which provided data on number of persons covered.) The plans are found in every region of the country, with a predictable concentration in the large industrial states. Three states—California, New York and Michigan—contain 75.9 percent of the total number of persons reported to be covered. Four additional states—Alaska, New Jersey, Ohio and Pennsylvania—account for 93.3 percent of the total number of covered persons.

TABLE 2.1.—LEGAL SERVICE PLANS: DISTRIBUTION BY STATE

State	Number of plans	Plans providing membership figures	Numbers of members	Percent of total
Alabama	7	6	65	0.009
Alaska	2	2	24,400	3.467
Arizona	2	1	1,140	0.162
California	80	46	202,450	28.768
Colorado	1	1	724	0.103
Connecticut	1	1	3,000	0.426
District of Columbia	3	3	11,090	1.575
Florida	15	12	1,803	0.256
Hawaii	23	17	4,704	0.668
Illinois	7	6	3,879	0.551
Iowa	1	1	220	0.031
Kansas	5	4	345	0.049
Louisiana	1	1	600	0.085
Maine	2	1	1,300	0.181
Maryland	26	23	4,143	0.589
Massachusetts	1	1	5,000	0.710
Michigan	5	5	144,807	20.577
Nebraska	1	1	10	0.001
New Jersey	3	3	24,700	3.510
New York	10	10	187,250	26.608
North Carolina	17	15	1,055	0.150
Ohio	15	11	31,191	4.432
Oklahoma	3	3	165	0.023
Oregon	12	12	400	0.057
Pennsylvania	5	5	41,815	5.942
Rhode Island	1	1	3,000	0.426
Texas	8	8	395	0.056
Utah	13	12	2,016	0.286
Virginia	3	2	630	0.089
Wisconsin	1	1	1,112	0.159
Total	274	215	703,409	99.945

Note.—From this data the mean size of a prepaid legal service plan in the study was found to be 3,271.6 members.

TABLE 2.2.—NUMBER OF PLANS BY SOURCE OF FUNDING

Funding type	Frequency	Percent
1. Employer, collective bargaining	36	13.2
2. Employer, unilateral	16	5.9
Subject to sec. 120		19.1
3. Union dues	34	12.5
4. Employee organization, general funds	12	4.4
Subject to sec. 120		16.9
Subject to ERISA		36.0
5. Individual payment, voluntary	165	60.7
6. Individual payment mandatory	3	1.1
7. Other	6	2.2
Subject to ERISA		64.0
Total	272	100.0

Table 2.2 depicts the distribution of plans over the 7 categories of funding source or sponsorship which were defined in Chapter 1. As shown in the table a high proportion of plans in the study are funded by individual payments, as compared to plans funded through employer or employee organization sources. Table 2.2 indicates that only 19.1 percent of the plans in the study population (plus the "found" plans) are funded by employers and thus subject to recognition as qualified group legal service plans under Section 120 of the Internal Revenue Code. 36 percent of the plans in the study are subject to the Employee Retirement Income Security Act. This figure, however, should be considered with caution since it is subject to two sources of variation. First the study did not inquire whether the employer groups were private or public entities. The group of employer plans in the study population is known to include several government plans, which are not subject to ERISA. Second, some of the individual payment plans may be minimally or informally sponsored by employee associations, and, depending on the facts and circumstances of each case, might be considered a plan "estalished and maintained. . . . by an employee organization."

Since funding through an insurance company may substantially change the character of a plan, the study examined the proportion of plans in the study population that were fully or partially insured. Recognizing that insured plans were substantially underrepresented in the study population, there still were 18.2 percent fully insured plans contained in the population.

TABLE 2.3.—PLANS FULLY OR PARTIALLY INSURED

	Fully insured	Partially insured	Not insured	Total
Frequency	30.0	3.0	132.0	165.0
Percent	18.2	1.8	80.0	100.0

2.2 Size of plans

While the average plan size nationwide was found to be 3,271.6, average plan sizes vary widely when controlling for different funding sources. Table 2.4 provides a breakdown of mean plan sizes by source of funding. Evident from the table are the extreme ranges in size of plans, even within certain funding source categories. Table 2.4 attempts to correct for extremes, providing mean sizes that are only slightly positively skewed if at all. The corrected mean for all plans provided in Table 2.4 excludes 3 cases with large plan sizes. If all individual payment plans were excluded, the corrected mean for plans in funding categories 1-4, ERISA plans, would be 2,915.7.

TABLE 2.4.—MEAN SIZE OF PLANS BY SOURCE OF FUNDING

Funding source	Number of—		Mean—	
	Persons[1]	Plans	Arithmetic	Corrected
1. Employer funded, collective bargaining	403,180	33	12,187.3	4,651.0
2. Employer funded, unilateral	17,310	14	1,236.4	50.8
3. Employee association, dues	244,879	33	7,420.6	2,965.0
4. Employee association, general funds	8,957	11	814.3	814.3
5. Individual payment, voluntary	28,589	117	244.4	203.4
6. Individual payment, mandatory	347	3	115.7	115.7
7. Other source	1,140	4	285.0	9.3
Total	704,402	215	3,271.6	1,393.4

[1] In all cases, "number of persons" refers to the number of primary covered persons, and does not include spouses or dependents unless specifically so indicated.

A comparison of the number and sizes of plans, as contained in Table 2.5 below, provides a more accurate picture of the plans by source of funding. Fully 95.8 percent of the persons covered by a legal service plan are members of plans subject to ERISA. Nearly 60 percent are members of plans subject to recognition as qualified group legal service plans under Section 120. Only 4.2 percent of the persons covered by legal service plans of the type described by this study are not subject to any sort of federal regulation.

TABLE 2.5.—NUMBER AND SIZE OF PLANS, BY SOURCE OF FUNDING

Funding source	Plans—		Persons—	
	Number	Percent	Number	Percent
1. Employer funded, collective bargaining	36	13.2	403,180	57.2
2. Employer funded, Unilateral	16	5.9	17,310	2.5
Subject to sec. 120				59.7
3. Employee association, dues	34	12.5	244,879	34.8
4. Employee association, General Funds	12	4.4	8,957	1.3
Subject to ERISA				95.8
5. Individual payment, voluntary	165	60.7	28,589	3.7
6. Individual payment, mandatory	3	1.1	347	0.0
7. Other	6	2.2	1,140	0.2
Subject to ERISA				3.9
Total	272	100.0	[1] 704,402	99.7

[1] Taken from 215 plans providing information as to both source of funding and number of persons covered. If weighted for aggregated plan clusters, total number of persons would be 707,163. The percentages would shift by half of a percent or less.

TABLE 2.6.—NUMBER AND PERCENT OF PLANS BY SIZE CATEGORY AND DATE OF ESTABLISHMENT [1]

Date establishment	1-499	500-999	1,000-2,499	2,500-4,999	5,000 or more	Total
1973	3	1	2	0	1	7
	42.9	14.3	28.6	0.0	14.3	
1974	4	1	2	1	4	12
	33.3	8.3	16.7	8.3	33.3	
1975	15	3	2	0	3	23
	65.2	13.0	8.7	0.0	13.0	
1976	13	3	3	0	2	21
	61.9	14.3	14.3	0.0	9.5	
1977	26	2	3	1	4	36
	72.2	5.6	3.3	2.7	11.1	
1978	44	1	2	3	4	54
	81.5	1.9	3.7	5.6	7.4	

TABLE 2.6.—NUMBER AND PERCENT OF PLANS BY SIZE CATEGORY AND DATE OF ESTABLISHMENT [1]—Continued

Date establishment	1-499	500-999	1,000-2,499	2,500-4,999	5,000 or more	Total
Total	105	11	14	5	18	153
	68.6	7.2	9.2	3.3	11.8	....

[1] Table excludes 1979 and 1980 plans, survey undercounts plans established after 1978; the master plan list was compiled during the summer of 1979

Because of the large number of very small plans, plans with fewer than 500 members comprise 63.9 percent of the plans. Plans with more than 5,000 members comprise 13.5 percent. Table 2.6 shows that while the number of large plans is increasing steadily, smaller plans form an increasingly larger proportion of the plans being established. This is explained in part by the fact that the individual payment plans, which tend to have a smaller mean size than plans established by the employer, the union or both, are being vigorously marketed commercially.

The size of plans also appears to be a function of the type of delivery system which is used. Plans characterized themselves as delivering services on either an open panel, closed panel or staff basis. (See Chapter One for detailed definitions.) Plans were also permitted to characterize their delivery systems as "other". It was found that this category was used by one of the larger plans whose delivery system was "mixed", that is, providing services through a variety of delivery mechanisms, depending on the concentration of members to be served.

Table 2.7 describes the number and mean size of plans by delivery system. (It is weighted for plan clusters and contains the "found" plans.) The Table reveals very large differences in average number of persons covered or plan size in open and closed panel and staff plans. As noted above, the one large plan which provides services utilizing a mixture of open, closed and staff delivery mechanisms, is included in the "other" category. If current trends continue and plans which provide services on a national basis continue to adopt the open panel delivery, there is a strong liklihood that the mean size of open panels will increase. This will especially be the case if the concentration of covered plan members is insufficient to support the establishment of closed panel or a staff delivery system.

The following section examines delivery systems in greater detail.

TABLE 2.7.—MEAN SIZE OF PLANS BY DELIVERY SYSTEM

Delivery system	Total number of persons	Number of plans	Average number of persons	Percent of persons
Open panel plans	16,995	54	314.7	3.8
Closed panel plans	82,797	75	1,104.0	62.4
Staff plans	194,330	43	4,519.3	....
Other	149,724	4	37,431.0	33.7
Total	443,346	176	....	99.9

2.3 Delivery system

As the previous section demonstrated, the plans tend, by more than two to one, to deliver services on either a closed panel (private law firm) or a staff basis. Two issues have been debated involving delivery systems. One is the degree of choice provided to the client-participant in the selection of an attorney. This issue involves ethical concerns, and also affects the degree of which the private bar generally is able to participate in prepaid legal work. The second issue, also involving both ethical and economic issues, is whether plans should be structured so as to provide services primarily through salaried attorneys or through the private bar. Section 302(c)8 of the Taft-Hartley Act (Labor Management Relations Act of 1949) expressly leaves the issue of delivery system structure to the parties in collective bargaining, to select "counsel or plan of their choice".

Open panel delivery systems by definition involve the private bar. Closed panel delivery systems generally involve small numbers of private law firms. While the study did not inquire about the method of compensation of attorneys, it can be assumed that closed panel law firms were not generally compensated on a salaried basis. Table 2.8 reviews the distribution of plans among the three basic types of

delivery system, examining the percent of plans and the percent of persons covered, in the context of the two delivery system issues.

Table 2.8.—Number of plans and number of persons covered by delivery system

<table>
<tr><th>Delivery System</th><th>Number of Plans</th><th colspan="2">Percents of Plans</th><th>Number of Persons</th><th colspan="2">Percents of Persons</th></tr>
<tr><td>Open Panel</td><td>54</td><td rowspan="2">Non-Salaried 73.3%</td><td>Unrestricted Selection 30.7%</td><td>16,995</td><td rowspan="2">Non-salaried 22.5%</td><td>Unrestricted Selection 3.9</td></tr>
<tr><td>Closed Panel</td><td>75</td><td rowspan="2">Restricted Selection 67.0%</td><td>82,797</td><td rowspan="2">Restricted Selection 62.4%</td></tr>
<tr><td>Staff Panel</td><td>43</td><td>Salaried 24.4%</td><td>194,330</td><td>Salaried 43.8%</td></tr>
<tr><td>Other</td><td>4</td><td>Mixed 2.3%</td><td>Mixed 2.3%</td><td>149,724</td><td>Mixed 33.7%</td><td>Mixed 33.7%</td></tr>
</table>

Table 2.9 compares the percent distribution of the three delivery systems by funding source. An examination of it reveals a somewhat mixed use of these systems. Employer-funded plans are equally divided between open panels and either closed panels or staff plans. That is, nearly one-half of the employer plans provided an unrestricted selection of attorneys. Employee association plans, regardless of whether funded by dues or from general association revenues, tended overwhelmingly to favor either closed panels or staff plans. Individual payment plans also tended to favor closed panel or staff plans over open panels by a three to one margin.

TABLE 2.9.—DELIVERY SYSTEM BY SOURCE OF FUNDING

[In percent]

	Open panels		Closed panels		Staff plans		Other	
	Row	Column	Row	Column	Row	Column	Row	Column
Employer-funded plans (types 1 and 2)	47.2	34.7	25.0	9.9	22.2	19.5	5.6	50.0
Employee association (types 3 and 4)	5.6	2.0	77.8	15.4	16.7	7.3		
Individual payment (types 5 and 6)	24.4	63.3	52.8	73.6	21.3	65.9	1.6	50.0
Other (code 7)			25.0	1.1	75.0	7.3		

The difference in the mean number of attorneys associated with open and closed panels is predictably large. Open panels involve an average of 687 attorneys; closed panels (law firms) involve an average of 28 attorneys. Comparable figures are not available for staff plans. The open panel figure is marginally useful as a national average; however, it is extremely sensitive to state size, since bar-sponsored plans attempt to secure broad attorney participation on their state panels. Because attorney population per state differs in direct proportion to the size (population) of the state, this figure in the future could represent little more than the proportion of attorneys participating nationally on an open panel, expressed as a per state average.

2.4 Benefit structure

Chapter One describes the three kinds of benefit structures currently in use in prepaid legal service plans. Briefly, they include the Hour Bank (client-participant is entitled to "x number of hours" of service), the Schedule of Services (listing each covered legal matter in a schedule), and the Shreveport Plan (division of benefits into functional categories: advice; office work; and representation with coverage provided fully or partially.)

A fourth category, Advice/Consultation, represents a type of group advice and referral plan which provides unlimited telephone advice and consultation, plus other services.

The plans in the study population were relatively evenly spread over the four categories:

	Percent
Hour bank	29.1
Schedule of services	14.3
Shreveport plan	31.7
Advice/consultation	21.2
Other	3.7

The different benefit structures appear to correlate fairly strongly with particular delivery systems. For example, nearly 90 percent of the Hour Bank plans are closed panels. Similarly, 75 percent of the Shreveport Plans are provided on an open panel basis, and nearly 80 percent of the Advice/Consultation plans are provided by staffs of attorneys. The Schedule of Services appears across all delivery systems, but it is found in conjunction with closed panels twice as often as with either open panel or staff plans.

Because of small cell sizes and statistically unreliable data values, no useful information is available on the mean number of hours of service provided by the Hour Bank plans. However, most plans appear to provide between 20 to 100 hours of service per person, maximum.

The various benefit structures do not correlate particularly strongly with source of funding. Plans funded by employers through collective bargaining are fairly evenly spread among the Hour Bank, Schedule of Services and Shreveport Plans. Employers funding plans unilaterally appear to prefer the Shreveport Plan. However, this preference is based upon a rather small number of cases. Employee association plans, both those funded from dues and those funded from general revenues, appear evenly spread across all three benefit structures, plus telephone advice and consultation. Individual payment plans utilize all four benefit structures (including telephone advice and consultation) in fairly even proportions.

2.5 Types of benefits

In the mail survey an effort was made to determine what types of legal matters are typically covered by legal service plans. Tables 2.10 and 2.11 provide, in descending order, lists of legal matters most often covered and most often excluded. The first three categories (advice, office work and court representation) are functional descriptions which accommodate the plans having a Shreveport plan type benefit structure.

From the table several aspects of plan coverage are particularly noteworthy:

(a) Misdemeanor and juvenile criminal coverage are more likely to be provided then felony coverage;

(b) Some plans provide felony criminal coverage only in the "emergency" stages of the felony matter—through arraignment only;

(c) Probate and personal injury coverage, both traditionally provided on a contingent fee basis, are covered in some way by a large proportion of the plans (69.1 percent and 56.3 percent respectively);

(d) Approximately one-half of the plans provide some coverage for the non-fee costs associated with legal services;

(e) Approximately half of the plans provide representation in tax court but few provide tax preparation services; and

(f) A substantial proportion of plan coverage involve legal matters where the government is a party or is being petitioned to grant some privilege or status.

There appear to be some significant differences in the contents of benefits packages between plans with different funding sources. Information was always obtained from respondents on those legal matters which were neither specifically included nor excluded from the benefits packages. Among responses from individual payment plans, this third category contained very consistently low or zero values, suggesting that individual payment plans are far more detailed in explaining what matters are and are not covered. Since there is higher adverse selection associated with individual payment plans, it is reasonable to expect greater care to be taken in defining the coverage available under these plans. Another factor is that Hour Bank plans, which by definition do not specify the legal matters on which the client's hours may be spent, include only a small proportion of individual payment plans. There are other significant differences in the contents of benefits packages between plans with different funding sources—as reported in Table 2.12. For instance, with one exception, individual payment plans provide, on the average, either the same or broader coverage than either employer-funded plans or dues-funded plans. ("Broader coverage" means the inclusion of more legal matters, but does not necessarily mean that the depth of coverage is better. That is, a plan may cover more legal matters, but provide less actual dollar coverage for particular matters or overall.)

Table 2.10.—Legal matters most often included by plans

Legal problem:	*Percent*
Advice/consultation	98.6
Court representation	95.7
Office work	94.1
Real estate matters	88.6
Wills	88.6
Consumer matters, including debt problems	88.2
Landlord/tenant	82.9
Family matters	82.6
Misdemeanors	80.9
Divorce	79.7
Governmental or administrative matters, including public benefits	77.3
Bankruptcy (personal)	75.4
Traffic matters	75.4
Juvenile matters	72.5
Felony matters—arraignment only	69.4
Probate	69.1
Felony matters—through trial	68.2
Personal injury and/or damage	56.3
Cost/expenses of litigation	52.6
Tax representation	48.5
Tax return filing	11.8

Table 2.11.—Legal matters most often excluded by plans

Legal problem:	*Percent*
Tax return filing	70.6
Costs/expenses of litigation	36.4
Tax representation	30.9
Felony matters—through trial	19.7
Felony matters—arraignment only	19.4
Personal injury and/or damage	18.8
Probate	17.6
Juvenile matters	17.4
Bankruptcy (personal)	14.5
Governmental or administrative matters, including public benefits	13.6
Misdemeanors	13.2
Traffic matters	11.6
Divorce	11.6
Family matters	10.1
Real estate	7.1
Landlord/tenant	7.1
Consumer matters—including debt problems	5.9
Wills	5.7
Court representation	4.3
Office work	1.5

The one area of exception is in coverage provisions for the costs/expenses of litigation, where fewer individual payment plans provide coverage. Table 2.12 displays only those legal problems in which coverage differs by source of funding, showing the percent of plans providing coverage for those specific legal problems.

TABLE 2.12.—BENEFIT COVERAGE DIFFERENCES (ONLY) BY SOURCE OF FUNDING

Legal problem	Percent of plans providing coverage to members		
	Employer-funded plans	Employee (dues) association*	Individual payment-plans
Family/divorce	76.5	37.5	91.4
Probate	56.3	37.5	83.5
Personal injury	37.5	42.9	64.7
Misdemeanors	68.8	50.0	88.6
Felony—arraignment	56.3	37.5	80.0
Felony—Trial	52.9	50.3	71.9
Juvenile matters	58.8	25.0	85.7
Traffic matters	58.8	37.5	91.4

TABLE 2.12.—BENEFIT COVERAGE DIFFERENCES (ONLY) BY SOURCE OF FUNDING—Continued

Legal problem	Percent of plans providing coverage to members		
	Employer-funded plans	Employee (dues) association[1]	Individual payment-plans
Governmental/admin	52.9	50.0	93.8
Tax return filings	6.3	25.0	11.4
Tax representation	29.4	25.0	61.8
Costs/expenses	62.5	62.5	54.5

[1] The small number of cases in this category produces less reliable figures.
Cell sizes were too small to yield reliable data for other sources of funding.

An examination of the breadth of coverage by delivery system produced reliable data only for open and closed panel plans. By a small margin (an average of less than 8 percentage points) open panels appeared to provide broader coverages than closed panels. The areas of major differences were in bankruptcy, tax representation and costs/expenses. In bankruptcy, 86.7 percent of open panel plans provided coverage as compared with 67.7 percent of closed panels. Seventy-nine percent of open panel plans indicated they provided coverage for tax representation while only 29 percent of closed panels indicated that they did so. Also, 70 percent of open panels provided coverage for the costs and expenses of litigation as compared with 51.7 percent for closed panels.

As for extent of coverage, the plans split fairly evenly on whether the benefits are subject to a ceiling on the total dollar amount of usage available per member per year. Those using a dollar ceiling comprise 47.2 percent of different plan types. Plans may use hourly or service limitations (i.e., five legal matters per year) instead of dollar ceilings. The fact that 52.8 percent of plans do not use dollar ceilings does not mean that plan benefits are unlimited. The mean size of the dollar ceiling for all plans using them is $2,947. A breakdown of mean size of the dollar ceiling by plans funding types is as follows:

Source of funding:	*Mean size of dollar ceiling*
Employer-funded, collective bargaining	$3,560
Employer-funded, unilateral	2,215
Individual payment plan	3,240

There is no sufficient data to determine a mean dollar ceiling for the employee association plans.

A note of caution is warranted in the conclusion that may be drawn from the dollar ceilings about the general level of benefits within categories of plans. Plans may utilize a variety of limitations and restrictions so that the dollar ceiling becomes relevant only under certain circumstances. For example, a plan may have a ceiling of $10,000 dollars on felony murder cases, and $2,000 on all other types of cases. For another example, two plans may have the same dollar ceiling, $5,000, but one may provide litigation coverage only in defense matters and another may also include selective plaintiff coverage. Dollar ceilings, therefore, are only one indicator of the extent of coverage.

Limited information is available on the use of copayments and deductibles by the plans. Forty percent of the plans do utilize copayments or deductibles. Their use is spread very evenly across plans of different funding sources. The legal matter category most often involving a copayment or a deductible is court representation. The mean size of the copayment or deductible for this benefit is $25/year.

2.6 Eligibility for plan coverage

In this section and the previous section (Section 2.5) no effort has been made to weight for plan clusters. The use of the term "plan" is this section refers to different plan types, and is not weighted for multiple plans of a similar type.

Plan eligibility provisions differ considerably depending on the type of organization sponsoring the plan or plan funding type. Eligibility provisions tend to be broader for plans forming part of a wage compensation package than for plans forming part of a package of membership services. Additionally, plans provided on an individual enrollment basis tend to have fairly generous provisions. Of course, individual payment plans which are not marketed in an employment context have virtually no eligibility restrictions; any person is eligible for service benefits who pays the premium. In the construction of Table 2.13 certain individual payment plans have been excluded for this reason.

Table 2.13 reports eligibility information on five different categories of potential covered persons by source of funding of the plan. In addition to the principal covered employee or member, a smaller number of plans also extend full or partial coverage to part-time employees. The high percentage of employee association plans funded through general revenues extending eligibility to part-time employees is somewhat anomalous and may reflect the small number of cases in the category.

TABLE 2.13.—PLAN ELIGIBILITY PROVISIONS BY SOURCE OF FUNDING

[In percent]

Funding type	Part-time employees	Retirees	Spouses and dependents	Officers	Owners and shareholder
Employer-funded plans (collective bargain.)	41.2	35.3	100.0	35.3	23.5
Employer-funded plans [1] (unilateral)	25.0	25.0	100.0	100.0	50.0
Employee association (dues)	44.4	33.3	66.7	11.1	0
Employee association [1] (general revenue)	50.0	33.3	50.0		16.7
Individual payment	40.9	45.5	59.1	43.2	25.0

[1] Small number of cases.

A fourth to one-third of all plans reporting extend eligibility for benefits to retirees.

The high proportion of individual payment plans extending eligibility to retirees is understandable; membership in the plan would be extended equally to active and retired employees since the employee is responsible for making payment to the plan.

Employer-funded plans universally extend coverage to spouses and dependents. (It was discovered that there is no difference in treatment between spouses and dependents and therefore they are treated as a single category of eligible.) Employee association plans are less likely to provide coverage to spouses and dependents although at least 50 percent do. This may be explained in part by the fact that many of these plans provide employment-related legal services.

Plans were asked whether officers, owners and shareholders were eligible to become members of the plans. It is significant that plans funded unilaterally by employers extend services to these categories of persons more often than do employer plans established through collective bargaining. However, some caution is required because of small frequencies. Employee association plans tend not to cover officers of their organizations.

Only 25 percent of all plans utilize a waiting period before plan members are eligible to use plan services. Individual payment plans were most likely to use waiting periods; 23.7 percent of those plans reported utilizing them.

Table 2.14 provides information about plan termination provisions. As might be expected, the three most common contingencies resulting in termination of plan membership were death, termination of employment, and retirement. Approximately ⅕ of all plans extend coverage to members on lay-off for a specific period of time after lay-off. Certain plans which were established in the early to mid 1970's almost universally extended eligibility to the spouse and dependents of a member who had died. Today, a small but still significant number of plans, 16.7 percent, have such a provision. These provisions appear to represent an effort to provide services to members and employees when they are most in need of them; employees on lay-off tend to experience substantial debt problems and widowed spouses experience significant problems associated with probate, real estate, and guardianship.

Table 2.14.—Termination provisions

Type of provision:	*Percent of plans*
Immediately in the layoff of the member	22.6
A specified amount of time after layoff of member	19.4
On retirement of member	54.8
On termination of member's employment	64.5
On termination of membership in union or employee association	25.8
At death of plan member	77.4
Other	12.5

2.7 Age and utilization experience of plans

Legal service plans have a very recent history. The first real growth in plans occurred only in 1973, and has continued at an increasing rate in succeeding years. Fewer than 8 percent of the plans, all of them funded by either employee associ-

ation or individual payment, were established prior to 1973. Using 1980 as a base year, Table 2.15 shows the ages of plans in the study population. (Plans established in 1979 and 1980, 12.8 percent of the study population, were excluded since only a small proportion of the total number of plans established in these years would have been included in the study population.)

Table 2.15.—Age of plans (base year: 1980)

Plan ages:	*Percent in age group*
2 years old (established in 1978)	32.3
3 years old (established in 1977)	21.2
4 years old (established in 1976)	9.7
5 years old (established in 1975)	16.7
6 years old (established in 1974)	6.1
7 years old (established in 1973)	3.5
More than 7 years (established prior to 1973)	9.9

Table 2.16 reports the total number of plans established by year and by source of funding, grouped by major funding type.

The first employer-funded plans in the study population were established in 1974. These plans comprised more than half of the plans established that year. The year 1975 was the first year showing a substantial increase in the number of individual payment plans. These plans increased from a 25 percent share of plans established in 1974 to better than a 60 percent share of plans established in 1975. They have consistently comprised a large proportion of plans established. As Table 2.16 shows, employer-funded plans have consistently been established at a rate two to three times greater than employee association plans. The number of employer and employee association plans established together only in 1976 has exceeded the number of individual payment plans established. The year 1976 appeared to be a year when fewer plans were established for all categories except employer-funded plans.

TABLE 2.16.—PLANS BY SOURCE OF FUNDING AND DATE ESTABLISHED

	Pre-1973	1973	1974	1975	1976	1977	1978	Total
Employer-funded plans (types 1 and 2):								
Number			7	8	10	8	13	46
Percent row			15.2	17.4	21.7	17.4	28.3	([1])
Percent column			58.3	24.2	45.4	19.0	20.3	([1])
Employee association (types 3 and 4):								
Number	15	3	2	4	3	2	7	36
Percent row	41.7	8.3	5.6	11.1	8.3	5.6	19.4	([2])
Percent column	83.3	42.9	16.7	12.1	13.7	4.8	10.9	([2])
Individual payment (types 5 and 6):								
Number	3	3	3	20	9	32	41	111
Percent row	2.7	2.7	2.7	18.0	8.1	28.9	36.9	([3])
Percent column	16.7	42.9	25.0	60.7	40.9	76.2	64.1	([3])
Other (types 7):								
Number		1		1			3	5
Percent row		20.0		20.0			60.0	([4])
Percent column		14.2		3.0			4.7	([4])
Total:								
Number	18	7	12	33	22	42	64	198
Percent	9.1	3.5	6.1	16.7	11.1	21.2	32.3	

[1] Combined types 1 and 2: 23.2 percent.
[2] Combined types 3 and 4: 18.2 percent.
[3] Combined types 5 and 6: 56.1 percent.
[4] Combined types 7: 2.5 percent.

Very limited data is available about plan utilization experience. Because the pretests revealed that closed panel plans tend to keep records on the basis of number of cases open and open panels on the basis of number of claims paid, different experience questions were constructed for open and closed panel plans reflecting these major diffrences in recordskeeping. Means were calculated for the number of cases and claims in 1977, 1978 and 1979. In the calculation of mean number cases for closed panel plans, however, there was no control for size of plan and the resultant mean is very large with an extreme positive skew because of the extreme sizes of some of the responding plans. Consequently no meaningful figure is available for the number of cases handled by closed panel plans.

Open panel plans are far more uniform in size the values for the mean number of claims paid were considered to be reliable. They are as follows:

1977: 139.2 claims paid per plan.
1978: 149.1 claims paid per plan.
1979: 162.4 claims paid per plan.

These values are not inconsistent with the mean size for open panel plans of 314.7 persons per plan.

2.8 Plans costs

Plans were asked about the amount of the contribution received by the plan on behalf of each member. The mean plan contributions, by funding source, are found in Table 2.17. The mean plan cost per member per year, across all plans, was found to be $78.73. Considerable difficulty was experienced by the plans in responding to appropriate questions on the mail questionnaire. Some appeared to think that the question asked for the aggregated contribution to the plan on behalf of all members rather than a per member per year amount. Accordingly, it was necessary for a plan expert to manually examine all responses to this question in order to identify incorrect data values. When incorrect values were identified, the procedure required them to be excluded from the group of responses, since there was a substantial risk of incorrectly calculating a per member per year figure based upon other data provided in the questionnaire.

One factor, the presence of telephone advice and consultation plans, is believed to have depressed the cost figure for individual payment plans. Telephone advice and consultation plans report their costs to be in the range of $30 to $45 per person per year. Nearly 20 percent of the study population consists of this type of plan. While no cross tabulation was done for cost by type of benefit structure, this sudy as well as plan literature indicates that telephone advice and consultation plans are frequently funded through individual payment plans, and also by employee association plans, but almost never by employer-funded plans. Accordingly, the cost figures for employer-funded plans can be characterized as covering plans uniformly providing comprehensive benefits, while cost figures for employee association plans include plan providing less broad benefits as well as plans providing telephone advice and consultation benefits. The cost figures for individual payment plans must be viewed as covering a mixture of both plans with comprehensive benefits, and plans providing telephone advice and consultation benefits.

Table 2.17.—Mean amount of contribution, per member per year, by funding source

Funding source:	*Amount*
1. Employer-funded, collective bargaining	$87.00
2. Employer-funded, unilateral	102.00
3. Employee association, dues	43.43
4. Employee association, general revenues	[1]
5. Individual Payment plans (voluntary)	74.11
6. Individual Payment plans (mandatory)	[1]
7. Other	84.00
For all plans	78.73

[1] No data available.

Plans were also asked whether additional contributions were required for members or employees with spouses and dependents. More than 92 percent of the plans indicated that no additional contribution was required. For those requiring additional contributions, the amount of the contribution ranged between $16 to $24.

One of the objectives of the study was to collect baseline data on the costs of open and closed panel plans in order to determine whether delivery system was a factor influencing plan cost. While some data was collected on direct and indirect plan costs, it is not sufficient to begin to undertake any examination of the delivery system question. Instead, the authors refer interested readers to a study presently being conducted under the auspices of the American Bar Association Prepaid Legal Services Committee by Professors Richard J. Arnould and Robert W. Resek (University of Illinois) compairing "the cost of staff panel and participating attorney panel prepaid legal service plans".

2.9 Summary and profile of plans

The study population is a subset of the universe of plans, and consists of approximately 60 percent of the universe. Insurance plans' are underrepresented in the study population. Otherwise, it is believed to be representive of the universe of plans. All of te plans in the study population have the following characteristics:

The plan is established, maintained or funded by a group, such that the group sponsors, collects funds, administers, or performs some function in connection with the plan;

The group associated with the plan is employment-related, consisting of either an employer, an employee association, or some other employment related organization;

The plan involves prepayment for services at the rate of $5.00 per member per year or more.

The plans include many diverse types and structures. The most important plan variable is source of funding. Three major and three minor funding categories were identified; the major categories include employer-funding, employee association (or union) funding, and individual payment. An important but secondary variable is delivery system.

Only the union or employee association plans have been in existence for any length of time; 41 percent of these plans in the study population were established prior to 1973. The first employer funded plan was not established until 1974 and individual payment plans did not begin to increase quickly until 1975.

Based on 215 plans reporting membership figures, 19.1 percent of the plans were employer-funded; these plans covered 59.7 percent of the people participating in plans. Union or employee plans counted for 16.9 percent of plans and 36.1 percent of people participating in plans. These two groups of plans account for 95.8 percent of people participating in prepaid legal service plans. The third category, individual payment plans, account for a substantial 64 percent of plans but only 4.2 percent of covered persons.

The mean size of plans (correcting for three extreme cases) is 1,393 persons per plan. The plans can be found in every region of the country, though not in every state. Considering only plans established by employers and employee associations, the mean plan size is 2,915 per plan.

The study population is characterized by a large number of extremely small individual payment plans and a smaller number of substantially larger employer and employee association plans. The employer and employee association plans include a number of extremely large plans, each of which is four or five times larger than the next largest plan in each group.

With the exception of plans providing primarily telephone advice and consultation benefits, benefits provided under all plans are reasonably comprehensive in scope. Only union or employee association plans provide more somewhat limited benefits.

In addition the following analysis revealed the following findings:

1. The most common areas of coverage provided by more than 85 percent of all plans were advice, real estate matters, wills, and consumer matters. Divorce was provided by nearly 80 percent of the plans.

2. A substantial majority of the plans provided coverage for juvenile, traffic, misdemeanors and felony criminal matters.

3. Probate and personal injury coverage, both traditionally provided on a contingent fee basis, are covered in some way by a large proportion of the plans (69.1 percent and 56.3 percent respectively).

4. Approximately half of the plans provide some coverage for the non-fee costs associated with legal services.

5. Nearly half of the plans will provide representation in tax court but few provide tax preparation services.

6. A substantial proportion of plan coverage involve legal matters where the government is a party or is being petitioned to grant some privilege or status.

A large proportion of plans extend eligibility to persons other than the primary participant. Spouses and dependents are most often covered, usually with no additional contribution or premium payment required. Retirees and part-time employees are also covered by a substantial number of plans. Unilaterally employer-funded plans are the only plans extending eligibility to officers, owners and shareholders in any significant proportion.

The second major plan variable, delivery system, provided an interesting but incomplete picture of the factors with which different delivery systems are associated. It was found that the open panel delivery mechanism, when correlated with size, has not been used by larger plans; 62 percent of plans use closed panel or staff delivery systems and 33 percent use a mixture of open and closed panel systems, leaving fewer than 5 percent of the plans utilizing only open panels to deliver services. Union and employee association plans and individual payment plans strongly favor closed or staff delivery systems. Employer-funded plans are evenly divided between open panel plans and closed or staff plans.

By a small margin, open panel plans do appear to provide benefit packages including slightly broader coverage (i.e., specifically covering more legal matter).

This is partially a function of the type of benefit structure, however, since many closed panels use an Hour Bank approach which does not limit coverage to specified legal matters.

The mean plan cost, across all plans, is $78.73 per person per year.

Following are brief profiles of major types of plans, categorized by sources of funding.

Employer-funded plans established through collective bargaining.—These plans first appeared in 1974, after a 1973 amendment to the Taft-Hartley Act made legal service plans a legitimate subject of collective bargaining. Their mean size is 4,651 persons per plan. At least one employer-funded plan is national in scope. Due mainly to the large size of the 1 plan, plans of this type account for nearly 60 percent of the persons presently participating in a prepaid legal service plan.

Employer-funded plans established through collective bargaining employ all of the different benefit structures which have been identified. The plans are evenly divided between open and closed panel delivery systems. Benefits are extended not only to employees but also to the spouses and dependents of employees. One-third of the plans extend eligibility to part-time employees and more than half also cover retirees. Fewer than a third extend coverage to officers, owners, or shareholders. For those plans using a dollar ceiling as a limitation on use, the mean amount of the ceiling is $3,560 per year, a higher figure than for plans of any other funding source. The mean cost per person per year is $87.

Employer-funded plans established unilaterally by employers.—These plans comprise the smallest type of plan, with a mean size of 50 covered persons per plan. They do not yet constitute a significant class of plans either in numbers of plans established or in numbers of persons covered. Similar to plans established through collective bargaining, the first unilaterally employer-funded plan was not established until 1974.

Legal services are provided through both open and closed panel delivery systems. Like the collectively bargained employer plans, spouses and dependents are provided coverage in all plans. Part-time employees are extended coverage in only 20 percent of the plans. However, the plans do provide coverage for retirees, officers, owners and shareholders 10 to 20 percent more often than collectively bargained plans. These plans have a dollar ceiling of $2,215 and cost $102 per person per year. This is the lowest ceiling and the highest cost per plan for which figures were available.

Union or employee association (dues) plans.—This category of plans constitutes 12.5 percent of plans and 34.8 percent of persons participating in plans, making it the second most important category of plans. The mean size (corrected) of dues-funded plans is 2,965 persons per plan; there is at least one extremely large plan included in the category.

The dues-funded plans differ in character from the employer plans in that their primary purpose is to serve members, not to compensate employees. Also, they are plans where the members, directly or indirectly through an elected representative, vote on whether to tithe themselves to pay for the program; the dues contribution comes directly out of the members pocket and is not subject to any kind of favored tax treatment.

These plans are usually provided on a closed panel or a staff basis. All kinds of benefit structures are found among the dues-funded plans, including plans providing primarily advice and consultation.

Two-thirds of the plans extend coverage to spouses and dependents and one-third extend coverage to retirees. Benefits are also somewhat limited than in employer-funded plans, covering fewer legal matters. (However, many dues plans utilize the Hour Bank benefit structure, which does not specify the legal matters which may be handled.) The mean cost of dues-funded plans is also lower, at $43.40 per person per year.

Union or employee association (general revenue) plans.—Like the unilaterally employer-funded plans, union or employee association plans provided through general revenues do not constitute a significant category of plans in terms of either numbers of plans or numbers of persons covered. The mean size of plan is only 814 persons. The small mean size compared to dues funded plans makes it difficult to characterize these groups except to say that they are small employee association groups with sufficient treasuries to fund their legal service plans out of general revenues without the necessity of having to seek a dues increase to fund the plan.

Legal services are provided using all kinds of benefit structures, but services are usually provided on either a closed or a staff panel basis. Spouses and dependents are covered in not quite two-thirds of these plans. Part-time employees are also covered in not quite two-thirds of the plans. This is a high proportion compared to

other funding sources. Fifty percent of the plans funded through general revenues include retirees. Only 25 percent extend coverage to officers of the group.

No data is available on the mean cost per person per year.

Individual payment plans (voluntary and mandatory).--Because there are so few mandatory payment plans, they have been grouped for purposes of discussion, with the voluntary plans.

These plans constitute the largest category of plans, more than 60 percent, and are perhaps the most diverse. However, individual payment plans also constitute a relatively small type of plan, with a mean size of approximately 200 persons per plan, and contain less than 5 percent of the total number of persons participating in prepaid plans.

In some cases these individual payment plans will not be plans subject to ERISA because they are not "established or maintained by an employer" as that phrase is interpreted by the Department of Labor and the court. Yet they are plans established in an employment context with a sufficient nexus to the employment group to be considered a group plan; importantly, the employers were aware of the plans and their employees' participation in it. These plans were included in the study population because of their potential for conversion to employer funding in the future.

Most of the individual payment plans could be characterized as "commercial" legal service plans. They are marketed to many different groups and often are centrally administered. Nearly three-fourths of these plans form part of a plan cluster. For some of these plans, the sponsoring group is an employer credit union; approximately 20 percent are advice and consultation plans.

By a three to one margin these plans provide services on a closed panel or staff basis; they include all of the different benefit types. Because plan participants individually pay their contribution or premium, individual payment plans have no reason to restrict coverage unless a client group requests that they do so. Nor surprisingly, therefore, individual payment plans have broad eligibility guidelines.

Benefits under individual payment plans appear to be extremely carefully defined and generally quite broad, extending to a wide range of legal matters. Also, dollar ceiling is comparatively high at $3,240. The mean cost is $74 per person per year, although this figure probably represents a mixture of low cost advice and consultation plans and higher cost comprehensive benefit plans.

MARYLAND STATE BAR ASSOCIATION, INC.,
Baltimore, Md., May 25, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Board of Governors of the Maryland State Bar Association, representing its 8,000 members in the State of Maryland, unanimously passed a Resolution at its meeting on May 19, 1981 to support the passage of Senate Bill 1039 which will have the effect of making Section 120 of the Internal Revenue Code permanent.

Very truly yours,

CHARLES O. FISHER, *President.*

THE IOWA STATE BAR ASSOCIATION,
Des Moines, Iowa, May 20, 1981.

Re prepaid legal services plans S. 1039.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Board of Governors on behalf of The Iowa State Bar Association unanimously endorses and supports S. 1039 which would make Section 120 permanent.

We sincerely hope that the above bill which you are sponsoring will be adopted by the Senate.

Respectfully,

EDWARD H. JONES.

AMERICAN FEDERATION OF STATE; COUNTY AND MUNICIPAL EMPLOYEES,
Washington, D.C., May 13, 1981.

Hon. BOB PACKWOOD,
Chairman, Senate Finance Subcommittee on Taxation and Debt Management, U.S. Senate, Washington, D.C.

DEAR CHAIRMAN PACKWOOD: On May 18, you will hear testimony on S. 1039, which makes permanent the exclusion from taxable income of amounts received under a qualified group legal service plan. The American Federation of State, County and Municipal Employees (AFSCME), a labor union representing more than one million public employees nationwide, urges you to support this legislation.

The Tax Reform Act of 1976 contained provisions to encourage employers to provide group legal services for their employees. Since that time, the number of employer-related legal service plans has grown at a tremendous pace. However, a provision of the 1976 Act which makes the value of legal service benefits provided by an employer tax-free for employees, will expire on December 31, 1981. Should this provision expire, the continued growth in the utilization of legal services by many working individuals in the moderate income bracket, may be diminished.

During the 97th Congress, recommendations to limit or eliminate the availability of legal services for the poor have been proposed. AFSCME opposed these proposals because of our strong belief and support of the right to legal representation of all Americans, regardless of their financial status. We, therefore, urge you to support S. 1039, which assures the continued existence of legal services provided by employers for employees.

We would appreciate having our letter inserted as part of the official record.

Sincerely,

JOSIAH BEEMAN,
Director of Legislation.

MCNEES, WALLACE & NURICK,
Harrisburg, Pa., May 20, 1981.

Hon. JOHN HEINZ,
U.S. Senator,
Washington, D.C.

DEAR SENATOR HEINZ: During the past ten years, I have been chairman of the Pennsylvania Bar Association Committee on Prepaid Legal Services. During that time, our committee has been active in advancing the development of group legal services plans, in order that a greater portion of middle income people will be able to obtain competent legal services during their times of need.

Among the early barriers to the proliferation of employer-funded legal services plans was the lack of a tax deduction for such contributions. This barrier was removed by the amendment of Section 120 of the Internal Revenue Code, which provided a tax exemption for such plans; however, as you are probably aware, this exemption would expire on December 31 of this year. I understand that your Senate Committee on finance conducted a hearing into this matter on May 18, and I am sure that you have received sufficient information and arguments in support of continuing this exemption. Federally and state funded free legal services plans have, for the most part, taken care of much of the need for legal services to the poor, and the higher income groups are usually able to afford their own legal services. The problem has been in providing legal services to the large middle income group who need to have a prepaid or employer-paid plan available for emergencies and unusual circumstances. In order to accommodate that need, and encourage the further development of employer-funded plans, we urge your support of Senate Bill 1039.

Sincerely,

J. THOMAS MENAKER,
Chairman, Committee on Prepaid Legal Services,
Pennsylvania Bar Association.

83-405 O—81——6

NEW YORK STATE BAR ASSOCIATION,
May 21, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: Average Americans have not secured equal justice under law. One reason has been the cost or fear of the cost. Employer-paid legal services plans are an important part of the solution to that problem. Accordingly, we strongly support your S. 1039, which will make permanent the provision by which legal services benefits under a qualified plan are not treated as income to employees. This is an important step in making into a reality the promise of our national heritage.

Very truly yours,

ALEXANDER D. FORGER,
President.

CONSUMER SERVICE CASUALTY INSURANCE CO.,
Pittsburgh, Pa., May 21, 1981.

Re Senate bill 1039.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: You have my full support in your efforts to remove the expiration date of December 31, 1981 from Section 120 of the Internal Revenue Code. This action making the tax exemption for employer-paid group legal plans permanent is most important.

Through Consumer Service Casualty Insurance Company (CONSERV), a wholly owned subsidiary of Blue Cross of Western Pennsylvania, I have been personally involved with employer-paid group legal plans since 1977 and have seen first-hand the positive impact of group legal plans for lower and middle income people. With the availability of employer-paid group legal plans, there is better access to attorneys. Many people don't seek the services of an attorney when they really need to because they don't think there are legal solutions to their problems; don't know an Attorney; don't know how to find an Attorney or fear the cost may be too high. Employer-paid group legal plans remove these barriers.

If the tax exemption for employer-paid group legal plans is not made permanent through Senate Bill 1039, progress made since 1976 in providing access to Attorney services will be lost.

Thank you for your efforts on behalf of legal service plans.

Sincerely,

CHARLES J. SCHNEIDER,
Financial/Operations Director.

CARR & BLACKWOOD,
Erie, Pa., May 21, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: I understand you are sponsoring a Bill to make the employer-group legal plan tax exemption permanent.

As a small, private practitioner, I find a great amount of my time spent in discouraging middle class clients from asserting their rights, because of the cost and expense of the process. The only citizens who can "afford justice" in America today are either the extremely poor or the extremely rich. Everyone in between either has to go into hock up to their eyeballs or forget it.

Perhaps an even worse problem is that almost none of these people will even consult a lawyer before entering into important transactions, such as buying a house, signing a contract, dealing with family problems, etc. If they could do this, it might well prevent the later, serious legal problems that require major investment. This would also, of course, relieve the pressure on our Court systems by reducing the number of lawsuits.

I believe there is major social benefit to be derived from expansion of all pre-paid legal systems. Generally-available legal consultation at a reasonable cost (along the

lines of group health insurance) would make the motto—"Government of laws, not of men"—meaningful for the great middle class majority.

Sincerely,

M. L. CARR.

THE FLORIDA BAR,
Tampa, Fla., May 22, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR PACKWOOD: The Florida Bar has actively promoted the development of group and prepaid plans for many years. We firmly believe that this system of delivering legal services provides access to attorneys that otherwise would not be available to a majority of the participants in group plans.

The Florida Bar strongly supports the continuation of qualified plans as a tax-free benefit to employees. The rapid growth in the number of plans and covered employees has been due, in part, to the tax benefits in force.

By copy of this letter, I am requesting the full support of Senators Hawkins and Chiles in the passage of Statute 1030.

Sincerely,

LEONARD H. GILBERT, *President.*

NORTH CAROLINA PREPAID LEGAL SERVICES CORP.,
February 24, 1981.

Re legal services tax provisions: Internal Revenue Code sections 120 and 501(c)(20).

Senator ROBERT PACKWOOD,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: We are writing to express our support for the reenactment of Sections 120 and 501(c)(20) of the Internal Revenue Code relating to the tax treatment of group legal services plans and administrators. We understand that you are planning to introduce legislation which would clarify and make permanent these provisions.

The Sections are of tremendous importance to the future growth and existence of group legal services programs in the United States. As you know, a coalition of organizations worked for the original passage of the measures. During these four years, plans have begun to develop throughout the country and are now at an important threshold of growth. The failure to extend these tax provisions may serve as the death knell for organizations such as ours. Many of the companies with which we are working have expressed concern about the continuation of these important tax provisions. It is our belief that most, if not all, of these companies will elect not to participate without these tax incentives.

North Carolina Prepaid Legal Services is a nonprofit corporation sponsored by the North Carolina State Bar pursuant to legislation passed in the 1975 General Assembly. The North Carolina State Bar is a state agency which regulates and licenses attorneys. NCPLS is not an insurance company but an administrative service for group legal service plans for employee groups throughout the state. NCPLS seeks to reduce the cost of legal services and at the same time to help educate the public about the law and the importance of legal services for adequate family protection. In four years NCPLS has provided legal services coverage to thousands of North Carolina families and paid out more than one half of a million dollars in fees to attorneys throughout the state.

Most of the plans which we presently have are employee paid plans where the employee is paying all or a large part of the premium. Because we are nonprofit, none of the income inures to the benefit of the organization. All premiums, less the administrative overhead of 15 percent or less, is paid to the servicing attorneys, who are themselves taxpayers. Most of the plans which will be developing in the future, however, will be paid for by employers.

The legal service tax sections provide a significant benefit to the subscriber who is participating in a qualified plan as defined under Section 120. Legal plans are placed on a par with the tax benefits available to group health plans presently administered by almost all employers. Cost conscious employers, seeking to reduce their own tax burden and to protect employee benefits, are looking for programs offering the highest tax incentives. Section 120 and IRS regulations are very unclear

as to what the parameters of "qualified" plans are. Proposed IRS regulations have only confused the providers and purchasers of group legal plans.

We urge your support of a clarified tax bill which will rectify the strained interpretation taken by the Service in its proposed regulations on Sections 120 and 501(c)(20), which took almost four years to complete. Several provisions of the proposed regulations are in direct violation of the letter and spirit of the law. For example, the proposed regulations state that a qualified plan must be funded by the employer. Section 120 states that plans may be qualified if the premium is paid in whole or in part by the employer. Such a narrow interpretation of the tax law will eliminate many prospective group plans in which the employer as a matter of policy does not fully fund any employee benefit. A hearing was held on the proposed regulations at which NCPLS testified in opposition to many of its provisions. The Service promised that the revised regulations would be promulgated by the first of January 1981.

Our efforts to obtain a tax exempt status under 501(c)(20) have been totally frustrating. We believe that bar-sponsored nonprofit legal plans such as NCPLS were clearly contemplated by Congress in 501(c)(20). We have been denied a tax exempt status, however, on three separate occasions, the last of which is enclosed for your review. NCPLS offers both qualified and nonqualified plans and the Internal Revenue Service has taken the position that because NCPLS offers any nonqualifying plans, it is not entitled to tax exempt status under 501(c)(20). The proposed regulations do not clarify whether organizations such as NCPLS would ever be entitled to a tax exempt status.

We also write to offer our assistance in anyway possible to further this legislation. We shall be happy to testify before any hearing or prepare any written report about our plan that may be helpful to you.

Thank you for your interest. We look forward to working with you on this very important matter.

Sincerely,

R. W. HUTCHINS, *President.*
B. E. JAMES, *Secretary-Treasurer.*
JOSEPH C. DELK, III, *Executive Director.*

Form 2848
(Rev. July 1976)
Department of the Treasury
Internal Revenue Service

Power of Attorney

(See the separate Instructions for Forms 2848 and 2848-D.)

Name, identifying number, and address including ZIP code of taxpayer(s)

North Carolina Prepaid Legal Services Corporation 56-1140121
107 Fayetteville Street
Raleigh, North Carolina 27611

hereby appoints (Name, address including ZIP code, and telephone number of appointee(s)) (See Treasury Department Circular No. 230 as amended (31 C.F.R. Part 10), Regulations Governing the Practice of Attorneys, Certified Public Accountants, and Enrolled Agents before the Internal Revenue Service, for persons recognized to practice before the Internal Revenue Service.)

Murray C. Greason, Jr.
Thomas L. Kummer
Womble, Carlyle, Sandridge & Rice
Post Office Drawer 84
Winston-Salem, North Carolina 27102 919-725-1311

as attorney(s)-in-fact to represent the taxpayer(s) before any office of the Internal Revenue Service for the following Internal Revenue tax matters (specify the type(s) of tax and year(s) or period(s) (date of death if estate tax)):

Obtaining exemption from federal taxation under Code §120 and 501(c)(20)

The attorney(s)-in-fact (or either of them) are authorized, subject to revocation, to receive confidential information and to perform on behalf of the taxpayer(s) the following acts for the above tax matters:

(Strike through any of the following which are not granted.)

To receive, but not to endorse and collect, checks in payment of any refund of Internal Revenue taxes, penalties, or interest. (See "Refund checks" on page 2 of the separate instructions.)

To execute waivers (including offers of waivers) of restrictions on assessment or collection of deficiencies in tax and waivers of notice of disallowance of a claim for credit or refund.

To execute consents extending the statutory period for assessment or collection of taxes.

To execute closing agreements under section 7121 of the Internal Revenue Code.

To delegate authority or to substitute another representative.

Other acts (specify) any other acts necessary

Send copies of notices and other written communications addressed to the taxpayer(s) in proceedings involving the above matters to (Name, address including ZIP code, and telephone number):

Thomas L. Kummer
Womble, Carlyle Sandridge & Rice
Post Office Drawer 84
Winston-Salem, N. C. 27102

and

North Carolina Prepaid Legal Corporatio
Post Office Box 25246
Raleigh, North Carolian 27611

This power of attorney revokes all earlier powers of attorney and tax information authorizations on file with the same Internal Revenue Service office for the same matters and years or periods covered by this form, except the following:

(Specify to whom granted, date, and address including ZIP code, or refer to attached copies of earlier powers and authorizations.)

Signature of or for taxpayer(s)

If signed by a corporate officer, partner, or fiduciary on behalf of the taxpayer, I certify that I have the authority to execute this power of attorney on behalf of the taxpayer.

[signature] (Signature) [signature] (Title, if applicable) 3/20/78 (Date)

(Signature) (Title, if applicable) (Date)

(The applicable portion of the back page must also be completed.)

Form 2848 (Rev. 7-76)

BEST COPY AVAILABLE

Schedule L Qualified Group Legal Services Plans (Section 120)

1 (a) Name of plan ▶ North Carolina Prepaid Legal Services Corporation Master Plan
(b) Plan number (see instructions) . . . . ______
(c) Plan year ends (Date) . . . . December 31

2 A qualification determination or ruling is requested for:
(a) [X] Initial qualification—~~date adopted~~ for Master Plan . . . . ______
(b) [ ] Amendment—date adopted . . . . ______

If you check (a), please submit a copy of the documents establishing the plan, including a copy of the plan and any related trust instrument. If the plan was subject to collective bargaining, include a copy of the collective bargaining agreement pertaining to it. If you check (b), submit a copy of the amendment.
Note: Once a plan has qualified you need not file a new Form 1024 with each amendment. However, the Service is to be notified of any subsequent amendments.

3 Describe the legal services covered by the plan, if they are not described in the plan or collective bargaining agreement.

4 Please give the following information (as of the first day of the first plan year for which you are filing this application): enter that date here (Give date) . . . . ______
(a) Total number of employees covered by the plan who are shareholders, officers, self-employed persons, or highly compensated . . . . ______
(b) Number of other employees covered by the plan . . . . ______
(c) Number of employees not covered by the plan . . . . ______
(d) Total number employed* . . . . ______
*Should equal the total of (a), (b), and (c)—if not, explain. Describe the eligibility requirements that prevent those employees not covered by the plan from participating.

5 Are all eligible employees entitled to the same benefits? . . . . [X] Yes [ ] No
If not, explain the differences.

6 Manner of funding the plan:
(a) [ ] Payments to insurance companies
(b) [X] Payments to organizations described in section 501(c)(20)
(c) [ ] Payments to organizations described in section 501(c), which are to pay or credit your payments to other organizations described in section 501(c)(20)
(d) [ ] Prepayments to providers of legal services
(e) [ ] Any combination of the above (Show which by letters) . . . . ______

Schedule M Trust or organization set up under section 501(c)(20)

1 (a) Was this trust or organization created or organized in the United States? . . . . [X] Yes [ ] No
(b) If so, was it created or organized to form part of a group legal services plan or plans qualified under section 120? . . . . [X] Yes [ ] No
If "Yes," enter plan name. ______
(c) If (b) is "Yes," has this plan (or plans) qualified under section 120? . . . . [ ] Yes [X] No
(d) If (c) is "Yes," please submit a copy of the ruling or determination letter(s). If "No," attach explanation.

2 If the trust or organization provides legal services or indemnification against the cost of legal services unassociated with a qualified group legal services plan, describe the nature and extent of these services.
The Corporation will provide services under a Group Contract identical to th Master Group Plan to groups of 10 or more persons even if they are not employed and the contract is not entered into by an employer.

3 Please attach copies of all organizational documents.

BEST COPY AVAILABLE

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, D.C., August 8, 1979.

NORTH CAROLINA PREPAID LEGAL SERVICES CORP.
Raleigh, N.C.

GENTLEMEN: We have considered your protest to our ruling of September 28, 1978, holding that you do not qualify for recognition of exemption from Federal income tax under section 501(c)(20) of the Internal Revenue Code of 1954.

On December 13, 1978, a conference was held in the National Office to discuss the issues involved.

We have considered all the material submitted, and it remains our conclusion, based on the fact that you will be offering plans financed by individual contributions rather than employer contributions, that you are not entitled to exemption from Federal income tax under section 501(c)(20) of the Code. Accordingly, our ruling of September 28, 1978, is affirmed.

We are advising your District Director of this action.

Sincerely yours,

J. A. TEDESCO,
Director, Exempt Organizations Division.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, D.C., September 28, 1978.

NORTH CAROLINA PREPAID LEGAL SERVICES CORP.
Raleigh, N.C.

GENTLEMEN: We have considered your application for recognition of exemption from Federal income tax under section 501(c)(20) of the Internal Revenue Code of 1954.

The information submitted shows that you were incorporated on September 3, 1975, under the laws of the State of North Carolina, for the purpose of improving the availability of legal services to the citizenry of the State. You carry out your purpose by acting as a depository for groups entering into contracts with you identical to the Master Group Contract, and disbursing the funds thus received in accordance with such contracts.

Any employer of ten or more employees may enter into a group contract on behalf of his employees. Although nothing in the Master Group Contract or in your charter, by-laws, or resolutions would exclude some entity other than an employer from entering into similar contracts, this is prohibited as a practical matter. You have indicated that you are willing to amend the language of the Master Group Contract to limit the contracting parties to employers, if necessary.

The Master Group Contract provides specified benefits consisting of personal legal services through prepayment of legal fees. However, in some instances the employer will make no contribution under the plan. You anticipate that plans of which you form a part will include those under which the employer makes all contributions, those under which the employer makes part of the contributions, and those under which the employer makes none of the contributions, except to the extent the employer bears the cost of administration of the plan.

Your Master Group Contract contains no language which would insure that, with respect to the plan of a contracting employer, not more than 25 percent of the amounts contributed under the plan during the year may be provided for shareholders or owners of more than a 5 percent interest in the employer.

Section 501(c)(20) of the Code provides, in part, for the exemption from Federal income tax of an organization or trust created or organized in the United States, the exclusive function of which is to form part of a qualified group legal services plan or plans, within the meaning of section 120.

Section 120 of the Code provides, in part, that a qualified group legal services plan is a separate written plan of an employer for the exclusive benefit of his employees or their spouses or dependents to provide such employees, spouses, or dependents with specified benefits consisting of personal legal services through prepayment, or provision in advance for, legal fees in whole or in part by the employer.

Section 120(c)(3) of the Code provides that not more than 25 percent of the amounts contributed under the plan during the year may be provided for the class of individuals who are shareholders or owners (or their spouses or dependents), each of whom (on any day of the year) owns more than 5 percent of the stock or of the capital or profits interest in the employer.

The information presented shows that in addition to section 120 qualified group legal services plans, you will also form a part of plans that do not qualify under section 120 of the Code because the legal services provided under the plans are not paid for in whole or in part by the employer. Therefore, you are not an organization the exclusive function of which is to form part of a qualified group legal services plan or plans within the meaning of section 120 of the Code. Moreover, there is no assurance that the plan of a contracting employer will meet the requirements of section 120(c)(3) of the code relating to the 25 percent limitation on contributions that may be provided for individuals who have a greater than 5 percent ownership interest in the employer.

Based on the above, we conclude that you do not qualify for exemption under section 501(c)(20) of the Code.

You have the right to protest this ruling if you believe that it is incorrect. To protest you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 21 days from the date of this letter and must be signed by one of your principal officers. You also have a right to a conference in this office after your statement is submitted.

If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he must file a proper power of attorney and otherwise qualify under our conference and practice requirements.

If we do not hear from you within 21 days, this ruling will become final and copies will be forwarded to the District Director, Atlanta, which is your key district for exempt organizations matters.

Sincerely yours,

JEANNE S. GESSAY,
Chief, Rulings Section 1,
Exempt Organizations Technical Branch.

WOMBLE, CARLYLE, SANDRIDGE & RICE,
Winston-Salem, N.C., April 10, 1978.

Attention Ms. Anita Karu.
Re E:EO: T: R: 1-1, application for exemption of North Carolina Prepaid Legal Services Corp.

JEANNE S. GESSAY,
Chief, Rulings Section 1, Exempt Organizations Technical Branch, Internal Revenue Service, Washington, D.C.

DEAR MS. GESSAY: This is in response to your letter dated March 16, 1978, requesting additional information to be considered with the Application for Recognition of Exemption of North Carolina Prepaid Legal Services Corporation. The Corporation is seeking a determination that it is exempt from taxation under Section 501(c)(20) of the Internal Revenue Code of 1954 (hereinafter "Code"), and that the Master Group Contract utilized by the Corporation is a qualified group legal services plan as described in Code Section 120.

Please find enclosed another executed Form 2848 Power of Attorney designating that Code Section 501(c)(2) and 120 are involved. Also please find enclosed a completed page 13 of Form 1024 (Rev. Oct. 1977). This page has been added to Form 1024 since the original application was submitted, and the submission of this page is intended to complete our application. The portion of the enclosed page 13 which requests information about a particular plan (such as the number and type of employees covered by the plan) cannot be completed and is really not relevant. We are seeking a determination that our Master Group Contract, which will be used by many groups, meets the requirements of code Section 120. I have signed a declaration and attached it to the page 13 submitted herewith. Please associate the page with the Form 1024 previously submitted, thereby incorporating it under the declaration made by Mr. James, Secretary of the Corporation, on the original application.

As stated in my letter of March 23, 1977, North Carolina Prepaid Legal Services Corporation was organized under a mandate from the North Carolina General Assembly to improve the availability of legal services to the citizenry of the State. The corporation was organized as a non-profit, non-stock corporation under the auspices of the North Carolina State Bar, a governmental agency. The purpose of the corporation is carried out by acting as a depository for groups entering into contracts with the corporation identical to the Master Group Contract (a copy of which is attached to the application), and disbursing the funds thus received in accordance with such contracts.

The groups which may subscribe to a group contract are not limited on the basis of social status, race, religion, political affiliation or employment status. Eligible groups must consist of 10 or more individuals, but eligible groups are not limited to employees under a group contract entered into by their employer for their exclusive benefit. In situations where the group contract is neither entered into by a "self-employed individual" within the meaning of Code Section 120(d)(1) nor by an "employer for the exclusive benefit of his employees" within the meaning of Code section 120(b), no tax deduction for the payments made to the corporation under the group contract will be allowable. Nevertheless, the corporation will collect and disburse such payments in accordance with the group contract. Naturally, it is anticipated that a large majority of the group contracts will be entered into by employers [within the meaning of Code Section 120(d)] no definition of "employer" in Section 120(d) except regarding unincorporated associations and partnerships for the exclusive benefit of their employees because of the tax deferral advantages provided by Code Section 120(a). Nevertheless, groups of persons who are not employees or groups of employees who are unable to convince their employer to enter into a group contract may wish to avail themselves of the protection afforded by a prepaid legal service plan even though no corresponding tax advantages will inure to them. This possibility is enhanced by the fact that North Carolina Prepaid Legal Services Corporation is a non-profit organization which will encourage participation by persons in need of quality legal services who would otherwise be unable to afford them. These perons may not be employed, or they may be employed by employers who choose not to participate in prepaid legal service plans for the benefit of their employees. North Carolina Prepaid Legal Services Corporation does not plan to exclude groups from its plans because they are not in a position to have an employer enter into the plan for their benefit.

It is our position that even though some group contracts may be entered into by groups under circumstances where an employer is not the contracting party, the Corporation qualifies under Code Section 501(c)(20) as an organization "the exclusive function of which is to form part of a qualified group legal services plan or plans, within the meaning of section 120". The word "exclusive" in Code Section 501(c)(20) should be given the same meaning as the term "exclusively" used in Code Section 501(c)(3). In the context of Code Section 501(c)(3) it has long been established that activities which further the organization's exempt purpose or are insubstantial even if not furthering that purpose do not result in disqualification. This is so even though Code Section 501(c)(3) required operation of the organization "exclusively" for charitable purposes. Applying the same meaning to the term "exclusive" in Code Section 501(c)(22), North Carolina Prepaid Legal Services Corporation undoubtedly qualifies since its activities with regard to group contracts which do not meet the requirements of Code Section 120 are in furtherance of its exempt purpose and are expected to be insubstantial. See Treas. Reg. Section 1.501(c)(3)-1.

Code Section 120(c)(3) provides that "[n]ot more than 25 percent of the amounts contributed under the plan during the year may be provided for the class of individuals who are shareholders or owners (or their spouses or dependents), each of whom (on any day of the year) owns more than 5 percent of the stock or of the capital or profits interest in the employer." You have asked how North Carolina Prepaid Legal Services Corporation will insure that employers will not violate this contribution limitation under the Master Group Contract. The Board of Directors of the Corporation has adopted two policies reflected in the minutes (certified copies of which are attached hereto) which guarantee that the above-mentioned provisions cannot be violated. First, no contract will be entered into with a group of less than 10 individuals. Second, the contributions to be made by the employer or other contracting party under the group contracts are fixed by the Board of Directors on the basis of a fixed amount per covered employee or individual. The contribution to be made under all contracts is the same per covered individual whether his spouse and dependents are covered by the plan, and whether he has any ownership interest in the employer. Thus, there is no possibility that the contributions made under the contract on behalf of any individual can exceed 10 percent of the total contributions. We read Code Section 120(c)(3) to disqualify the plan only if an individual 5 percent owner (or his spouse or dependents), who is also an employee, has contributions made on his behalf by the employer which discriminate against other employees by exceeding 25 percent of the total contributions under the plan. Any other reading would penalize small family owned businesses. For example, the Master Group contract would allow a family corporation owned by 10 shareholder-employees all of whom are 10 percent owners to enter into a group contract for the benefit of its employees, even if the shareholders are the only employees. We believe it was not the Congressional intent to eliminate small businesses from participation in group legal services plans of enactment of Code Section 120(c)(3).

As you know, we are quite concerned about the time which has already lapsed since the filing of our initial application. We are open to suggestions on how any problems in issuing the requested determination letters can be eliminated. Though we believe our Master Group Contract as well as our organizational documents form a sufficient basis for issuing the requested determination letters, if amendments are needed we need to know immediately. In the interest of time, we again request an immediate conference with you and any other representative of either the Internal Revenue Service, Chief Counsel's Office, or Treasury Department who will be involved in approving the determination letters. We believe such a conference would be very constructive in clearing the way for a favorable ruling, and provide us the opportunity to work out any problems which are standing in the way of issuance of the determination letters. I will look forward to hearing from you within the next week scheduling a conference in Washington to discuss this matter.

Sincerely,

THOMAS L. KUMMER.

Enclosure.

DECLARATION OF ATTORNEYS

The undersigned, Thomas L. Kummer, hereby declares that the foregoing letter was prepared by him and that although he does know of his own knowledge that the facts stated herein are true, he believes them to be true and correct.

ADVOCARE,
Cleveland, Ohio, May 12, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR: I am writing a brief letter to indicate my support for the extention of Senate Bill 1039 to remove the expiration date of 12/31/81 from Section 120 of the Internal Revenue Code thereby making the tax exemptions for employer-paid group legal plans permanent. Medical Mutual of Cleveland, Inc., the Blue Shield carrier in Northeast Ohio, is actively marketing a group pre-paid legal insurance program and the tax exempt status has been sighted as a benefit to the employer.

As our complex society continues to evolve the average citizen needs the services of an attorney to protect his interest in everyday transactions today more than at any time in our previous history. We and the government should do everything in our power to enhance the possibility that today's citizen will be able to obtain legal protection at a reasonable cost.

The tax exempt status offered by Senate Bill 1039 is a clear indication that the government is willing to recognize the employers efforts in providing legal protection for its employees.

Sincerely,

PAUL R. MILO,
Assistant Vice President, Special Markets.

ASSOCIATION GROUP INSURANCE ADMINISTRATORS,
Santa Barbara, Calif., May 13, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C

DEAR SENATOR PACKWOOD: I am writing you in support of your legislation, Senate Bill No. 1039, regarding removing the expiration date of December 31, 1981 from Section 120 of the IRS Code.

As an insurance agent, I have seen how legal service plans have benefited employees and their families. It's not very often that an employee benefit can actually remove some of the red tape in our lives and make us more productive and useful people.

Thanks for your support.

Sincerely,

JOHN B. WIGLE, *Vice President.*

LARRY M. CHESHIER,
Santa Monica, Calif; May 14, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C

DEAR SENATOR PACKWOOD: I am writing to express my support for your introduction of Senate Bill 1039. By making Section 120 of the Internal Revenue Code permanent, employers and employees will benefit. The employees of our great nation will have ready access to legal assistance which will prevent many problems before they develop. The employers will be able to offer their employees a meaningful benefit at a nominal cost, thus avoiding inflationary wage increases.

Legal benefits for employees is something which should not be delayed any further. Your bill will make legal services available to millions of Americans, for which all will be thankful.

All my support and best wishes for your efforts.

Sincerely,

LARRY M. CHESHIER.

FLORIDA LAWYER'S PREPAID LEGAL SERVICES CORP.,
Tampa, Fla., May 19, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.
Re employer-paid group legal plans

DEAR SENATOR PACKWOOD: I am writing in support of your efforts for passage of Senate Bill 1039, which removes the expiration date of December 31, 1981, from Section 120 of the Internal Revenue Code. As a marketer of group prepaid legal plans it concerns me that this important benefit continue to enjoy the same status as other qualified employee benefit plans. Our efforts to-date have stressed this equality. Without it, employers will not consider a concept that can be of great value to workers across the country.

Best wishes in your efforts!

Sincerely,

ROBERT D. BRANDT,
Director of Marketing.

ILLINOIS STATE BAR ASSOCIATION,
April, 1981.

Re group legal services plans/tax status.

Under the *Tax Reform Act of 1976, Title 26, Section 120* was amended to provide that amounts contributed by an employer to qualified group legal services plans did not become taxable gross income to the taxpayer. The same statute provided that the fair value of the legal services provided under such a plan were not taxable to the employer.

That provision of the law will expire on December 31, 1981.

While group legal services programs in Illinois have not developed as rapidly as the Illinois State Bar Association had hoped at the time of the enactment of the 1976 statute, it is the opinion of the Association that group legal services programs will continue to grow, and will become the vehicle by which middle-class Americans will be able to obtain and afford quality legal services in the years to come. Farm groups, blue collar workers, clerical workers, civil servants, teachers and countless other salaried persons stand to benefit from group legal services programs.

It is the recommendation, therefore, of the Illinois State Bar Association that members of the Illinois Congressional delegation support legislation in the year 1981 that will make the tax reforms to Title 26, Section 120 permanent. We believe that such legislative action will help to stimulate the increase in growth of group legal services programs as an employer fringe benefit.

The Illinois State Bar Association will be pleased to offer members of its staff to assist you in obtaining up-to-date information on group legal services programs in Illinois and elsewhere. Please feel free to contact either Mr. Dickason or Mr. Braverman at the Association's Headquarters, 424 South Second Street, Springfield, IL 62701, Telephone 217/525-1760.

ILLINOIS STATE BAR ASSOCIATION,
Springfield, Ill., May 14, 1981.

Re SB 1039/tax-exemption for employer-paid group legal services plans.

Hon. ALAN J. DIXON,
U.S. Senator,
Washington, D.C.

DEAR SENATOR DIXON: You may recall that when Illinois State Bar Association President Robert Heckenkamp and Messrs. Feirich, Dickason and I visited you recently, one of our legislative concerns upon which we provided you with a position statement (another copy attached) related to making permanent the tax-exemption for employer-paid group legal plans.

Senate Bill 1039, introduced by Senator Packwood, would accomplish this end and we urge your affirmative vote when the bill reaches the floor. Meanwhile, we hope that you will express our sentiments to any colleagues who solicit your opinion.

Respectfully yours,

H. H. BRAVERMAN.

ILLINOIS STATE BAR ASSOCIATION,
Springfield, Ill., May 14, 1981.

Re SB 1039/tax-exemption for employer-paid group legal services plans.

Hon. CHARLES H. PERCY,
U.S. Senator,
Washington, D.C.

DEAR SENATOR PERCY: You may recall that when Illinois State Bar Association President Robert Heckenkamp and Messrs. Feirich, Dickason and I visited you recently, one of our legislative concerns upon which we provided you with a position statement (another copy attached) related to making permanent the tax-exemption for employer-paid group legal plans.

Senate Bill 1039, introduced by Senator Packwood, would accomplish this end and we urge your affirmative vote when the bill reaches the floor. Meanwhile, we hope that you will express our sentiments to any colleagues who solicit your opinion.

Respectfully yours,

H. H. BRAVERMAN.

CONNECTICUT GENERAL LIFE INSURANCE CO.,
Hartford Conn., May 19, 1981.

Hon. ROBERT J. DOLE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR DOLE: We urge you to support Senate Bill 1039, introduced on April 29, 1981 by Senator Bob Packwood.

This bill would amend Internal Revenue Code Section 120 by continuing to make tax-free the value of legal services benefits provided by employers for employees. The section, which currently allows for such treatment, would otherwise expire on December 31, 1981.

As Senator Packwood has pointed out, the estimated number of employer-related legal services plans grew from 75 in 1975 to 400 in 1980. Approximately one million employees now benefit from these plans, with their numbers rapidly increasing.

As with medical insurance, dental insurance, life insurance and other benefits provided on a group basis, group legal services can provide for people of moderate means, fundamental benefits which would otherwise be foreclosed to them because of cost.

Legal planning, advice and counsel are truly important to a vital democracy and economy. They are as important as providing through insurance, for the health care of workers and for the hardships encountered at the death of a family member.

For these reasons, we encourage that the provisions already incorporated in Internal Revenue Code Section 120 be extended. Your support of Senate Bill 1039 will assist American citizens and employers in responsibly planning on their own initiative for benefits which will have a strengthening effect on the entire nation.

Sincerely,

G. ROBERT O'BRIEN,
Senior Vice President.

PRE-PAID LEGAL INSURANCE CO., INC.,
Aberdeen, S. Dak., May 13, 1981

Re Senate bill 1039.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: This letter is written to voice our support of your Senate Bill 1039 and to urge Congress to make Internal Revenue Code, Section 120, which expires on December 31, 1981, a permanent tax provision of the Internal Revenue Code.

You are to be congratulated for your efforts in attempting to create legislation which would tax exempt individuals who participate in employer paid group legal plans. We, too, feel as you do that the Tax Reform Act of 1976 is an important part of obtaining the goal of helping people of modest means have fair access to lawyers.

We wholeheartedly support your efforts.

Yours very truly,

WILLIAM J. VAN DE ROSTYNE, *President.*

GOUDIE & ASSOCIATES,
Sacramento, Calif., May 11, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: I am the managing partner in GOUDIE AND ASSOCIATES, we administer a prepaid legal plan. The A.P.I. informed me that you were doing some good work on S. 1039. I would like to congratulate you on your sense of responsibility. A reform in the delivery of legal services is long overdue. You are serving all Americans in your efforts. I wish you all the encouragement in the world.

Sincerely,

DAVID M. GOUDIE.

MACKELL & ROBERTSON,
Forest Hills, N.Y., May 12, 1981.

Re S. 1039 by Packwood

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR: The above captioned bill will make the exclusion of amounts received under a qualified group legal services plan permanent.

In 1976 Congress enacted two tax provisions to encourage employers to provide group legal services for their employees. Those changes were enacted with the Tax Reform Act of 1976.

One of the provisions, IRC Sec. 120, expires on December 31, 1981. This section makes the value of legal services benefits provided by an employer, as it should be, tax-free for employees, just the same as health benefits, etc. The bill makes this section permanent.

I have been a legal provider in this field of group legal services since their inception. It's a real opportunity for plans to expand and grow so that more and more people who can least afford attorneys, "the working stiff," may now say, "I'll see my lawyer about that."

Best wishes.

Sincerely,

THOMAS J. MACKELL.

RIDDELL, WILLIAMS, IVIE, BULLITT & WALKINSHAW,
Seattle, Wash., May 12, 1981.

Re Senate Bill 1039

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: I am writing in support of Senate Bill 1039 which you have introduced to make a tax exemption for employer-paid group legal plans permanent. I apreciate your introduction and support of this sensible legislation.

Sincerely,

GORDON W. WILCOX.

NEW JERSEY STATE BAR ASSOCIATION,
Trenton, N.J., May 13, 1981.

Hon. ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: I am writing to you on behalf of the New Jersey State Bar Association to express our support for Senate Bill 1039, making permanent the tax exemption for employer-paid group legal plans, under Section 120 of the Internal Revenue Code.

The New Jersey State Bar Association is committed to making legal services readily available to all citizens of the State of New Jersey. Making Section 120 permanent will promote the continued existence and growth of legal services plans provided by employers for their employees.

Thank you for your consideration of our views. We have communicated our support of S-1039 to our Congressional Delegation. If the New Jersey State Bar Association can assist you further, please do not hesitate to contact us.

Very truly yours,

WALTER N. READ, *President.*

THE BAR ASSOCIATION OF METROPOLITAN ST. LOUIS,
St. Louis, Mo., May 27, 1981.

Re S. 1039

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am taking this opportunity to write to you as the President of the Bar Association of Metropolitan St. Louis on your proposal to make the provisions of Section 120 of the Internal Revenue Code permanent. We endorse and support the provisions of S. 1039 as strongly and as enthusiastically as possible. Our Association has been laboring in the vineyards of prepaid legal services for several years, with mixed success. We were convinced that the enactment of the Packwood Amendment to the 1976 Tax Amendments would finally give the same treatment to legal services that most of the other employee benefits had received years ago. However, as you pointed out in your statement on the Senate Floor on April 27, 1981, for some reason the Internal Revenue Service has consistently drug its feet in carrying out the mandates of the 1976 Act, to the extent of obviously discouraging any qualification of a prepaid plan.

We feel that the permanent extension of Section 120 of the Code is vital to the maintenance of plans and methods to make adequate and competent legal services available to the vast majority of working Americans. The expiration of Section 120 would work to the distinct disadvantage of the working Americans who are just now being given the benefits of affordable legal services. We sincerely support your efforts to make the provisions of Section 120 permanent.

Sincerely,

ANTHONY J. SESTRIC, *President.*

STATE BAR OF WISCONSIN,
Madison, Wis., May 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We are writing in support of S. 1039 which would continue Section 1200 of the Tax Reform Act of 1976 in effect under which group legal plan benefits are placed on roughly the same footing as group medical plan benefits. Prepaid legal services plans are an important vehicle for delivering affordable legal services to Americans of modest means. Therefore, it is critical to the growth of such plans that employer contributions to and the value of legal service rendered from employer-funded "qualified" legal services plans shall not be taxable to the employee. We commend you for your sponsorship of S. 1039 and would urge the Congress to support its passage.

Very truly yours,

LAWRENCE J. BUGGE, ESQ., *President.*
JOHN H. BOWERS, ESQ.,
Chairman, Committee on Group and Prepaid Legal Services.

AMERICAN PREPAID LEGAL SERVICES INSTITUTE,
Chicago, Ill., May 28, 1981.

Senator ROBERT PACKWOOD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: The American Prepaid Legal Services Institute ardently supports passage of S. 1039 to make permanent Section 120 of the Internal Revenue Code.

As you may know, the American Prepaid Legal Services Institute is a non-profit technical assistance and educational organization devoted to the growth and development of prepaid legal service plans. In the course of our work, we have had occasion to consult with many hundreds of lawyers, consumer groups, labor organizations, insurance carriers and others involved in setting up legal service plans as an employee benefit.

From our first-hand experience in dealing with the subject area, we believe that we can state unequivocally that Section 120 has fulfilled its purpose in providing an incentive for employers to make legal services available to middle income employees on an efficient and cost effective basis. Public employees in New York, Pennsylvania, Ohio and Alaska; laborers in Louisiana, Connecticut, Massachusetts, and many other states; auto workers in 44 states across the country and teachers in Michigan, Pennsylvania and Minnesota are now able to seek needed personal legal services under plans established by their employers—plans which would not be in operation today but for the existence of Section 120.

Our discussions with employers considering the implementation of a plan for their employees indicate that the permanence of Section 120 is upper-most in their minds in considering whether and when to start the programs which they are contemplating. We are therefore convinced that the establishment of Section 120 as a permanent part of the tax code will remove the last remaining barrier to the growth of these plans, thereby enabling millions of employees to seek legal services on a preventive basis and gain access to the American system of justice to which they are entitled.

While wholeheartedly in support of S. 1039, our position is qualified, based upon issuance of final regulations by the Internal Revenue Service for the administration of Section 120. It is our position that the regulations as proposed thwart the original intent of Congress which was to provide a liberal atmosphere for gaining qualified status. The proposed regulations are overly restrictive and unrealistic in view of the wording contained within Section 120.

The Institute has submitted extensive comments on the proposed regulations and has provided testimony based upon these comments. In the absence of modifications to the proposed regulations to bring them into conformity with the comments submitted, we would urge consideration be given to amending S. 1039 to incorporate our primary concerns regarding the interpretation placed upon the definition of personal legal services, the limitations placed upon initial consultations with an attorney, limitations on the amount of permissible employee contributions and the lack of reasonable penalties for violations of the Section.

We commend you for your interest in this issue and pledge whatever support we can lend you.

Sincerely,

LAWRENCE M. WOOD, *President.*

STATEMENT BY JULIUS TOPOL ON BEHALF OF DISTRICT COUNCIL 37 MUNICIPAL EMPLOYEES LEGAL SERVICES PLAN (MELS)

Mr. Chairman, my name is Julius Topol. I am the Administrator and Chief Counsel of the DC 37 Municipal Employees Legal Services Plan, which is known as MELS. The Internal Revenue Service has determined that MELS is a qualified group legal services plan under Section 501(c) 20 and that MELS otherwise complies with the requirements of Section 120 of the Code. In lieu of testimony, I am submitting this statement today in support of S. 1039, which would make permanent Section 120 of the Internal Revenue Code.

MELS is operated by a trust fund established pursuant to a collective bargaining agreement between the City of New York and the largest union of municipal workers in New York City: District Council 37 of the American Federation of State, County and Municipal Employees, AFL-CIO. MELS opened for clients in September, 1977. The trust receives prepayments from New York City and a number of other public employers for the support of this plan.

MELS employs more than 50 lawyers on a full-time, salaried basis to provide a substantial range of personal legal services to covered public employees, their spouses and dependents. No fees are charged for these professional services.

The MELS plan serves 125,000 city workers and their families. The city's police, firefighters, teachers, and transit workers are represented by other unions and not included in MELS.

Many of the covered persons are the "working poor"; the rest are modestly paid. The bulk of them earn between seven and thirteen thousand dollars a year. They are the clerical persons in all the City agencies, the school lunchroom workers, school aides and paraprofessionals; the non-professional City hospital workers; the blue collar workers who maintain the highways, the water system, the sewers, the parks and the zoos; and a small number of professionals on the City payroll who work as social workers, accountants, public health nurses and computer programmers.

Many of these workers have legal problems stemming from the difficulties of making out in this inflationary period with a low or middle-income—difficulties such as debt problems and threatened evictions or cutoff of services. They also have consumer problems of all kinds, and problems securing government benefits. A good number have marital problems that require legal representation for their solution. And many find the need for help in providing for the disposition of their property after death. MELS provides them with legal advice and representation for all these matters.

Before MELS opened its doors in September, 1977, these workers had nowhere to turn for help with their personal legal problems: they made too much for legal services which were available to the poor, and not enough to pay private lawyers.

The Union was aware of their plight, because many workers with legal problems stopped in at the Union's legal department to ask for help. This department, which I then headed, was staffed with labor lawyers, equipped to handle job-related problems only. We tried referral, but this was highly unsatisfactory. The members made too much to be referred to offices giving legal services to the poor. Referral to bar association panels usually did not work out: either the workers did not have enough money to pay private fees or the private lawyers could not or would not take on small cases.

The Union decided to find out the dimensions of the members' need for personal legal services, and to explore ways of meeting that need. With the assistance of a consultant from Columbia University, we conducted a survey of the membership. Over half the replies to the survey, including many from people who had used lawyers, indicated they still needed legal help. Of these, nearly two thirds said they hadn't retained a lawyer because they thought it would cost too much; more than one-third said they did not know how to go about finding or choosing a competent lawyer; others said they did not have the time to hunt for one, or just did not trust lawyers.

The Union next set up a pilot program to deliver a wide range of civil legal services to a sample of DC 37 members. This Union project was co-sponsored by the Columbia School of Law and Social Work, and jointly underwritten by the Union and the Ford Foundation.

The idea was to see what kinds of legal needs the members had, and how many, so that predictions could be made about setting up a permanent legal services

program. The pilot project also explored ways to deliver these services in the best way for the least amount of money.

This pilot program ran for two years. It amassed data on the kinds and number of legal needs of the members and the cost of delivering legal services to meet those needs. It developed delivery systems and management information systems to monitor quality while controlling costs. Based on the information gathered during this period, it was decided that a contribution of $26 per annum per employee to the MELS trust could provide a significant package of personal legal services benefits to the covered employees and their families. This benefit package included advice, counsel and representation in the following matters:

Disputes over buying or selling goods and services (if the amount in dispute is over $100.); eviction proceedings; will; debt problems, including bankruptcy; divorce, separation, and annulment; securing government benefits; correcting credit ratings; disputes with public utitlities; review of documents; and defense in civil law suits, when such representation is not available under insurance policies.

MELS' lawyers advise and counsel members on covered problems. They also represent clients, going to court when necessary. Many thusands of members, and their families, have used MELS' services: its lawyers have represented them in resisting evictions from their homes. They have counseled and represented them in consumer matters, bankruptcies, and other debt problems. They have prepared thousands of wills. MELS' staff have helped members secure government benefits, and represented them in hearings before those agencies. They have counseled members and represented them in family matters such as divorce, separations and annulments.

Starting this fall, MELS' lawyers will represent covered members in these additional matters: buying and selling a home; family matters involving disputes over support, custody and visitation of children; applying for orders of protection; adoption and name change.

As one device to monitor the quality of our services, we mail questionnaires to clients when their cases are closed, asking them to check answers to some 30 questions dealing with the quality of the services received, and then inviting their comments on any aspect of the service they received. Almost half the recipients return the questionnaires to us. Of these 96 percent said they were satisfied with the treatment they received at MELS. Many of our clients have added comments to their questionnaires. A sampling of these comments follows:

"When I called MELS I was real desperate and almost going out of my mind. I didn't know what to do next. I was given an attorney the same day, and received legal advice from him right away."

"Mr. F. was assigned to my case. He was courteous at all times and promptly reviewed my case. After discussing my case with Mr. F. I felt confident he would handle my case satisfactorily and he did."

"Words cannot describe what MELS has meant."

"Without MELS, my case may have gotten me in an inescapable situation. You have my support. I will tell other DC 37 workers about it. Thank you."

"Attorney M. handle my case, and I must say that I was very pleased about the way he followed-up his work. I hope he will continue to work well and stay with our union, because we need the Law that has a concern for the people as well as the Money."

"I could not ask for anything better and I am so happy over the outcome of my case. I will never worry again if I have any problems because I can always come back to Mels."

"I was going to write a note of thanks to Ms. D. for the way she made me feel, comfortable and at ease. She explained anything in laymans english."

When Congress enacted Section 120 in 1976, providing that the value of legal services delivered under a qualified group legal services plan be excluded from the employee's gross income, MELS was still in the planning stages. This exclusion was crucial in the decision to go forward with the MELS program, which opened its doors to clients in September, 1977. There were strong indications then that, however beneficial the program might be to them, our hard-pressed lower and middle income members would not find it acceptable if they were required to pay substantial income taxes because of the value of the services they had received.

Since 1976, the members' real income has lagged far behind the rise in the cost of living. If S. 1039 were not passed, and MELS clients were forced to pay income taxes on the value of the services they receive after December 31, 1981, there is strong reason to fear that the MELS program would be in serious jeopardy.

83-405 O—81——7

STATEMENT BY MARC STEPP ON BEHALF OF UNITED AUTOMOBILE, AEROSPACE, AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

Mr. Chairman, my name is Marc Stepp. I am a Vice-President of the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). The UAW represents approximately 1,300,000 workers and their families in North America. I am Director of the UAW's Chrysler Department, and have served as one of the UAW's representatives on the Administrative Committee of the UAW Legal Services Plan.

The UAW wholeheartedly supports the bill which has been introduced by Senator Packwood—S. 1039—to make permanent Section 120 of the Internal Revenue Code, which excludes from gross income the value of employer contributions to or services provided by a qualified group legal services plan. The UAW believes that Senator Packwood's bill represents an important step towards insuring that quality legal services are available to the average American worker.

Legal services have traditionally been available only to the very rich and the very poor. Wealthy individuals and corporations have been able to pay the high cost of retaining private attorneys. And the poor have had access to free legal services from legal aid clinics sponsored by federal, state and local government. Meanwhile, the average American worker has been left out in the cold. The average worker cannot afford to hire a private attorney. At the same time, the workers makes too much to qualify for free legal services from a legal aid clinic. The net result is that the needs of American workers for legal representation—whether it be in connection with consumer, real estate, probate, or other personal legal problems—have gone unmet.

The addition of Section 120 to the Internal Revenue Code via the Tax Reform Act of 1976 represented an important breakthrough in this area. This provision for the first time granted pre-paid legal services benefits a tax status similar to that enjoyed by health care and other fringe benefits commonly enjoyed by employees, by allowing individuals to exclude from their gross income the value of employer contributions to or services provided by a qualified group legal services plan. This in turn enabled labor unions, for the first time, to negotiate pre-paid legal services benefits for American workers, in the same manner as other fringe benefits, and to thereby make high quality legal services available to the average American worker at reasonable cost.

Since the enactment of Section 120, the UAW has been in the forefront of the development of group legal services plans. The most important breakthrough has been the establishment of the UAW Legal Services Plan in 1978. This Plan is currently providing personal legal services throughout the United States to over 100,000 Chrysler employees and retirees, and their dependents. Most of these legal services are provided by full-time attorneys working out of eleven offices in eight different areas around the country. The remainder are provided through cooperative private attorneys. The legal services which are provided to participants are prepaid—that is, they are provided without cost to the participants. the UAW Legal Services Plan is run by an Administrative Committee composed of three persons appointed by the UAW and four independent members. This structure places both cost and quality controls in the hands of disinterested persons and persons representing the consumer of the legal services.

The UAW believes that the UAW Legal Services Plan is an important first step in addressing the unmet needs of workers to legal representation. The Plan is demonstrating that high quality legal services can be provided to workers at a relatively low cost. Moreover, it is demonstrating that this can best be accomplished through a delivery system akin to the HMO model in the health care area.

The UAW Legal Services Plan has been received enthusiastically by Chrysler workers and retirees. The utilization of services under the Plan has been extremely high. In addition, the comments from our members indicate that they have been very satisfied with the quality of legal services provided under the Plan, and continue to regard these services as a valuable fringe benefit.

In view of the enthusiastic response from our membership to the UAW Legal Services Plan, the UAW remains committed to building on this important precedent. The UAW has already developed a proto-type group legal services plan which can be negotiated with smaller employers in the independent parts and suppliers industry. And the UAW will continue to make pre-paid group legal services a demand in negotiations with the major auto, aerospace, and agricultural implement companies.

In order for pre-paid group legal service plans to continue to grow and develop, however, it is essential that they be accorded the same tax status as other fringe benefits enjoyed by American workers. When Congress enacted the Tax Reform Act of 1976, it included Section 120 for precisely this reason. Based on our experience since 1976, the UAW is convinced that pre-paid group legal services plans are

valuable fringe benefits, which for the first time are giving American workers meaningful access to legal representation. The UAW therefore urges this Subcommittee to support the bill which has been introduced by Senator Packwood to make Section 120 permanent (S. 1039), so that American workers can continue to have access to legal representation through pre-paid group legal services plans.

Thank you.

Statement of the National Education Association on Legal Services Tax Exempt Status

LEGAL SERVICES TAX EXEMPT STATUS

The 1.7 million member NEA is pleased to have an opportunity to present testimony in support of S. 1039 which would provide permanent tax-exempt status to employer-provided legal service plans. We applaud the leadership of Chairman Packwood in the effort to make these programs a permanent tax-free fringe benefit.

Education employees in several states have bargained with their employers plans which provide prepaid legal consultation and reduced rate legal assistance. If the tax-exempt status of these plans is allowed to expire, our members will lose a valuable benefit.

Public employee fringe benefits

Employer-provided fringe benefits were not normally available to education employees until fairly recently. Prior to the 1970's most education employees paid almost all of the cost of health and life insurance and retirement benefits. In recent years, public employers have become more willing to assume a portion of the cost of these plans. However, it is still unusual for an employer to pay the total cost of employee benefits, so education employees still pay a portion of the cost of what is normally provided without cost to private sector worker. In most cases, the employer-provided fringe benefits are exempt from federal taxation.

Legal service plans

Because of the nature of public employment, education employees are not afforded many of the employer-sponsored and paid fringe benefits provided to private employees. Stock option and profit sharing plans, use of company cars, and the like are not available to education employees. One relatively new fringe benefit which is bargained increasingly frequently by education employees is prepaid legal services. It is one of the very few fringe benefits available to public employees which is not permanently excluded from federal income tax.

Even though there are currently relatively few education employee legal service plans, more are being bargained each year. One impediment to achieving the benefit is the temporary nature of the tax exemption. It is our belief that more plans would exist if the exemption were permanent. NEA supports the permanent exemption of legal service plans as provided in S. 1039.

IRS proposed rules

The IRS has proposed rules for enforcing the tax-exempt status of legal service plans. NEA objected to several of the interpretations of the law made by the IRS. It is important to NEA members that these rules reflect Congressional intent. In our opinion, it may become necessary for Congress to restate its intent toward the tax-exempt nature of legal service plans so that these unnecessary barriers proposed by IRS will be removed.

We have a problem generally with the rules because they appear to be more restrictive than necessary. However, we are most concerned about obtaining a clear understanding of the following issues.

Definition of personal legal service.—The proposed IRS rules would seem to prohibit the use of prepaid funds for anything than legal services. The effect might be to preclude the use of funds for the administration of a plan.

Limited initial consultation.—The proposed regulations indicate that prepaid funds cannot be used to provide a consultation where documents are reviewed. There is also some question as to the number of consultations permitted. The net effect of the IRS provision would be to discourage preventive legal services.

Employee contributions.—The IRS rule would prohibit the qualification of a plan as a tax-exempt fringe benefit if any portion of the plan cost were paid by the employee. This short-sighted, discriminatory rule jeopardizes almost every prepaid legal service plan available to education employees. The IRS refuses to recognize the reality that in public employment few benefits are fully paid by the employer. The rule is also contrary to established federal policy which allows an employee to contribute a portion of the cost of other non-taxed fringe benefits.

If a change in the law is needed to clarify this concern, we would support a provision which allowed employee contributions to be excluded from the consideration of the tax-exempt status of a fund. We would also support a statement which allowed the fringe benefit to be tax-exempt if the employer paid at least one-half of the cost of the plan.

Conclusion

The tax-exempt status of prepaid legal services programs is an important issue to education employees. Even though the number of plans is relatively small, more plans are being implemented each year. Providing permanent tax-exempt status for these plans will foster their development.

Legal service plans are important to education employers as well as education employees. The concept of preventive legal service provides more employee productivity and less absenteeism for legal matters because legal problems can be identified while they may be more easily resolved.

We encourage you to enact S. 1039 so that legal service plans will have a permanent tax-exempt status. We also ask that you carefully review any new rules on fringe benefits published by the IRS. Education employees are already heavily taxed. Taxing any heretofore non-tax-exempt fringe benefits will add a further burden to an already beleaguered financial situation faced by many education employees.

Thank you for the opportunity to present this testimony.

STATEMENT OF PETER D. FARRIS, ESQ., FOLEY & CHHABRA, P.C.

Mr. Chairman and Members of the Committee, my name is Peter D. Farris. I am a member of the law form of Foley and Chhabra, P.C. I am licensed to practice law in the State of Maryland and the District of Columbia. I am submitting this statement concerning S-1039 on behalf of my Firm. Provision of legal services to a wide range of people at a reasonable cost is a matter of great interest and concern in our society today. Too many persons are precluded from handling routine legal matters because of the cost. I wish to bring to the Committee's attention considerations which we believe will affect the desirability and feasibility of small company participation in a group legal services' plan, and with the provision of such legal services by small law firm.

My remarks will be brief and candid. As a small law firm, we are developing group legal service plans for small, local businesses. Unlike medical services, legal services are easily provided, without great investments in physical plant. There are no legal equivalents of hospitals, x-ray, or dialysis machines. However, as currently drafted, Internal Revenue Code ("Code") Section 120 and the Proposed Regulations discouraged the provision of service by law firms in general and by small firms in particular.

Consider first the requirement that a plan be "written" and provide "specified benefits," as contained in Code Section 120(b). The writing need be no more than an agreement to provide services at a fixed rate or, as would be most desirable for a small business and law firm, for a reduced rate retainer, the exhaustion of which leads to a fixed rate, hourly charge for additional service. The specification of benefits need be no more than a concise statement which defines the services to be excluded (e.g., litigation among members of the plan, operation of a trade or business). The Internal Revenue Service ("IRS") exaggerates both of these requirements in its Proposed Regulation Section 1.120. Proposed Section 1.120(b)(2) provides that:

"[T]he requirement for a separate plan is not satisfied if personal legal services are provided under an employee benefit plan that also includes . . . non-legal benefits."

Under this rule, a separate section in an insurance plan disqualifies the plan.

Furthermore, in Proposed Section 1.120(c), the IRS would exclude most of the services that a general practice lawyer might provide. The following are examples of matters which would be prohibited by this proposed regulation:

1. Your daughter receives a bad check from a neighbor, while selling Girl Scout cookies;
2. Your child has trouble keeping accounts straight with the route manager on a newspaper route;
3. The last paycheck a spouse received when leaving a job bounced; and
4. There is a going business in an estate which you are, as an heir, entitled to inspect.

All of the above are matters which lawyers see regularly, are "personal" to the individuals involved, and are excluded under the Proposed Regulation.

The law permits company sponsored insurance plans, or pre-paid medical plans to cover "personal" medical accidents that are non-job related. It should equally permit company sponsored legal plans to cover such personal "mishaps", as listed above, as well as others. Code Section 120 should therefore be amended to permit expenditures for personal legal services. The marketplace would prescribe the reasonable limits on such expenditures.

Another section requiring modification is the contribution limitation provision contained in Code Section 120(c)(3), which virtually precludes small law firms from providing service and employers in general from establishing plans. Only insurance sponsored plans are viable under the provisions limiting expenditures on owners and management to 25 percent. A small law firm cannot "spread the risk" among many participants, as an insurance company can. The small firm is therefore disadvantaged in three ways.

First, because it does not offer an open plan to many different employers, it is limited to those employers who have a low percentage of shareholders or owners to other employees. Otherwise, if every employee received identical services (e.g., a professional corporation owned by three doctors employing two nurses), the 25 percent limitation would be exceeded and the plan would be disqualified. The insurance company could "average" its participation by balancing such a firm against one with the opposite and complementary composition (e.g., a professional corporation owned by one dentist, employing three dental hygienists and two secretaries) to avoid disqualifying the plan.

Secondly, the small law firm would always fear that, if it provided service to a shareholder or owner, the payment for services on such person's behalf would exceed the 25 percent limitation. Even deferring payment for the service until the next plan year, which would be financially disastrous to the law firm, might not mitigate the percentage problem.

Thirdly, a shareholder or owner would be less likely to deal directly with a small firm. That person would calculate that his utilization might disqualify his plan, unless he were participating in a larger group, where his percentage use of the plan would be balanced by staff utilization.

One could argue that these problems are resolved by having an insurance company spread the risk of several employers in a combined plan. The argument is illusory. No insurance company pays out more than it receives, thus there is always a profit factor built into the system, before the lawyer even enters the picture to dispense service. The small law firm provides service on a use basis, which can result in lower long range costs, assuming the use and hourly charge for legal fees factors are a constant.

A major danger of an arbitrary numerical limitation on percentage use by owner/managers—and any numerical limitation will be chosen arbitrarily—is a potential disqualification of the plan, based upon an unintentioned violation of the numerical limitation, and doing exactly what the plan was designed, for i.e., using the service. Approximately one-third of the Proposed Regulation addresses the numerical limitation. And any violation of the Regulation could lead to disqualification of a plan, for more than a year. Furthermore, it is not just the use of the plan by management and shareholders that potentially disqualifies the plan. The Proposed Regulation provides the same limitation upon "highly compensated individuals." Such individuals could include top commissioned salespersons or an individual who receives a large salary bonus, because that person perfected a new chemical process on behalf of the employer. Medical plans contain no such limitation, as long as the plan is available equally to all employees. It is no easier to predict the need for legal services by the individuals within an organization and their families, than it is to predict the medical needs of such a group. Just as the decision to use the medical services should be left to the doctor and the patient, so then should the decision to utilize legal services be left to the lawyer and the client.

Code Section 120(d)(c) also should be amended. The requirement for prior notice to the Secretary, contained in that section, further discourages participation by smaller businesses. The larger an organizations is, the more readily it can produce reports, notices, directives, and other paperwork. For the smaller business, and therefore for the employer, a simpler reporting requirement, after the plan has been established, could provide all of the information needed by the IRS. All such information could be provided on a single page, with the plan presumed qualified, if it met certain broad criteria (e.g., universal coverage, notice to all employees, a general statement of coverage or inclusiveness of the service plan). In addition, no plan contributions should be disqualified retroactively, unless the plan is demonstrated to have been fraudulently conceived. Rather, the plan administrators should be permitted to amend the plan, to establish equitable coverage.

It has been noted that one large group is notable for not filing comments in opposition to the Code Section 120 and the Proposed Regulation Section 1.120. There is a reason. The largest present users of legal service plans in this City, the labor unions, are exempt from the limitations established by Code Section 120 and its companion Regulations. There is no logical reason to exempt such plans, merely because they are "bargained for", while at the same time severely restricting similar plans, just because they are "offered" by employers to all employees equally.

Finally, we wish to focus attention on a provision that should be included in the new Code Section. The Section should prescribe a maximum period of one year from the date of commencing employment that a new employee may be placed on a probationary period and excluded from participation in the company's legal services' plan. Some period is necessary for a probationary status, just as with insurance companies, to preclude someone from using the new employer as a means of taking care of personal matters. Also, the pre-paid, or employer paid legal services' plan is a major investment on the part of the employer, and should not be mandated for coverage of a transient employee, or one who is not committed to a long term relationship with the company. A one year period for this purpose is a reasonable period of time.

Thank you for permitting me to present our views regarding this important piece of legislation.

BANKERS LIFE & CASUALTY,
Chicago, Ill., May 20, 1981.

Re: Senate bill 1039.

SENATOR ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR PACKWOOD: Bar association surveys have indicated that the great majority of Americans are not using the legal system to their best advantage, even though lawyers are not in short supply. Most of the barriers between the average American and the legal system have a common element, the fear of the unknown:

Do I really have a legal problem? Do I need a lawyer? How do I find the right one? What can a lawyer do for me? What will he charge?

Pre-paid access to legal services and legal insurance will, in our opinion, help reduce the frequency with which these questions go unanswered in the minds of average Americans, with the result that more Americans will seek timely legal advice, avoid legal problems, and keep minor problems from becoming major problems. We anticipate that the benefits to be derived from the growth of pre-paid legal services and legal insurance will parallel the benefits wrought by the growth of medical insurance.

Through our affiliate, Bankers Multiple Line Insurance Company, we have taken some bold initiatives in marketing individual legal insurance, and are considering entry into the group legal insurance market. We believe that the growth of legal insurance and pre-paid legal services will require the same favorable tax climate which has been afforded medical insurance. We therefore support and urge passage of Senate Bill 1039 which seeks to make permanent Section 120 of the Internal Revenue Code.

Very truly yours,

DUANE W. CHAPMAN, *Senior Vice President.*

AFSCME, OHIO COUNCIL 8,
Columbus, Ohio, June 1, 1981.

Hon. ROBERT PACKWOOD,
U.S. Senator, Chairman of Finance Committee, Taxation and Debt Management, Senate Office Building, Washington, D.C.

DEAR SIR: It is with extreme good pleasure we note your zealous and persistent effort through sponsorship of S. B. 1039 which maintains the continuity of programs which ar uniquely qualified and conferred with a taxation exempt status.

The Columbus Pre Paid Legal Service Plan is one such program with tax exempt status. Debasement of our tax exempt status would seriously destroy some credibility of virtue respecting the Legal Service Plans programatic viability.

Specifically the plan is designed to assist those who can ill afford to pay the cost of providing vitally needed legal services thus required.

Taxation of payment for legal fees as provided by the plan would reflect a callous indifference to the urgency of the plan motivation as it relates toward enhancement

of purchasing power in this era of inflation with repression. Be encouraged to continue the struggle; for your cause is right, just and proper. You can be assured our support is positive.

Very truly yours,

Rev. WARREN H. JENNINGS,
Treasurer, Ohio Legal Services Fund Inc.,
Board of Trustees.

VIRGINIA STATE BAR,
Richmond Va., May 26, 1981.

Hon. ROBERT PACKWOOD,
Chairman Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate Washington, D.C.

DEAR SENATOR PACKWOOD: The Virginia State Bar has been supportive of the development of prepaid legal services for many years and I write to express this State Bar's support of Senate Bill 1039 which deals with the taxation of prepaid legal services plans.

If enacted, S. 1039 would provide that amounts received by employees under a qualified group legal services plan would not be taxable as income to employees. Hence, employers would be encouraged to provide legal services to employees as a fringe benefit because of the favorable tax treatment.

The Virginia State Bar believes that the favorable tax treatment which would be provided By S. 1039 will serve the public interest by encouraging the expanded use of legal services. The potential loss of revenue to the Treasury Department would be more than offset by the potential benefit to the public.

Sincerely,

JAMES C. ROBERTS, *President.*

TRI-STATE LEGAL SERVICES TRUST FUND,
Milford, Conn., May 19, 1981.

Senator ROBERT PACKWOOD,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR: We urge that the Congress pass Senate Bill 1039 to remove the expiration date of December 31, 1981 from Section 120 of the Internal Revenue Code in order to make permanent the tax exempt status of qualified group legal service plans.

We are writing to you as Co-Chairmen of the Tri-State Legal Services Trust Fund. This Fund provides the security of a comprehensive legal benefits program to more than 7,000 Teamster members and their families in the states of Connecticut and Massachusetts, for a covered population of approximately 20,000 persons. These members, together with their participating contributing employers—who number in the hundreds—and the participating attorneys in Connecticut and Massachusetts have all expressed their satisfaction with this new program which has been in operation since the fall of 1980.

We enclose a copy of the booklet which explains this legal services plan, and we offer to provide whatever additional information you and the Senate Committee on Finance may find helpful in your consideration of S. 1039.

Respectfully,

FRED J. ROBERTO.
DONALD VALLERIE.

THE CUYAHOGA COUNTY BAR ASSOCIATION,
Cleveland, Ohio, May 28, 1981.

Hon. ALBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This letter will express to you the support of the Cuyohoga County Bar Association for your Bill S. 1039, which is intended to make Section 120 of the Internal Revenue Code permanent, and thereby preserve the deductible feature of employer contributions for legal service plans.

This Bar and its 2,000 members have for many years stood firmly behind the adoption of Group Prepaid Legal Service programs. These programs have been

instituted by the Cuyahoga County Bar Association, and I have had the opportunity of chairing the Prepaid Legal Services Committee for the past two years, as well as directing the efforts of the Committee through my services as President of this association in the year previous to my first year as chairman.

Our efforts to date have shown a plan adopted in conjunction with Medical Mutual of Cleveland, Inc., whereby it is the unique privilege of this Bar to be involved in the only Medical Mutual-Bar Association Group Prepaid Legal Service Plan that we know to be in existence in the United States. The offices of the Bar and those of Medical Mutual have been in the process of working with several labor organizations with the anticipation that there will soon be in effect many employer funded plans that will rely upon the current state of the law for their continued existence.

If the deductible features of Section 120 of the Code were to be eliminated, the efforts of this Bar, as well as the efforts of all other Bars in the United States that have been attempting to bring Group Prepaid Legal Service Plans to the consumer, would be thwarted. Though the success of these plans cannot be shown by numbers at this time, they nonetheless will grow in the future as the need for legal services is brought forward to the members of the consuming public. A new project takes many years before the fruits of its labors come to bear. This Bar feels confident that with the efforts being placed at this time, results will begin to show shortly.

For these reasons, your proposal to extend the life of Section 120 of the Internal Revenue Code in perpetuity is ardently and enthusiastically supported.

Very truly yours,

STANLEY D. GOTTSEGEN.

THE STATE BAR OF CALIFORNIA,
San Francisco, Calif., May 28, 1981.

Re S. 1039, Tax exempt status of group legal services plans.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR PACKWOOD: On May 28, 1981 the Board of Governors of the State Bar of California adopted the following resolution:

"*Resolved,* That the Board of Governors authorizes the President of the State Bar to forward a statement of support to Congress endorsing the appropriateness of bill S. 1039 which, if adopted, will make Section 120 of the Internal Revenue Code permanent."

In behalf of the State Bar of California, I want to indicate our strong support for the above legislation which we understand is intended to make permanent Section 120 of the Internal Revenue Code. We agree that adoption of this legislation will help assure the continued existence and growth of legal services provided by employers for employees. Considering the large number of employees who now benefit from these plans, continuation of the tax exemption will facilitate increased access to legal services for people of limited means.

Yours sincerely,

ROBERT D. RAVEN.

THE MISSOURI BAR,
Jefferson City, Mo., May 28, 1981.

Re Prepaid legal services tax amendment.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In my capacity as President of The Missouri Bar I am writing to express The Missouri Bar's support for the extension of Section 120 of the Internal Revenue Code, which permits employer contributions to and the value of legal services received from employer-funded "qualified" legal service plans not to be taxable to the employee.

The Missouri Bar supports the concept of prepaid legal services and believes that the tax treatment afforded by Section 120 is crucial to the further development of this form of delivery of legal services.

Very sincerely yours,

JOSEPH E. STEVENS, Jr., *President.*

UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION,
Washington, D.C., June 1, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Senate Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The UFCW strongly supports S. 1039 legislation to make permanent the income tax exclusion for the value of legal services provided by qualified group legal service plans.

Since the enactment of legislation authorizing the establishment of group legal service plans, 400 plans covering more than one-million workers have been formed. Our goal of affordable, quality legal services, for workers is just now beginning to be realized. The enactment of S. 1039 is essential to the attainment of that goal.

In enacting the original temporary tax exclusion, Congress felt that a tax incentive would not only encourage the establishment and use of the legal service programs but would also grant workers some relief from the high cost of legal services.

Although the present temporary tax exclusion has clearly been an asset to the group legal services program, the uncertainty associated with its temporary status has occasionally adversely affected the establishment of the very program it was designed to enhance.

We believe the enactment of S. 1039 will encourage employers to provide legal services for their employees, as well as encouraging the utilization of this benefit by employees. We urge its speedy adoption.

In closing, we request that this letter be included in the hearing record on S. 1039.

Sincerely,

ARNOLD MAYER,
International Vice President, Director of Government Affairs.

DETROIT BAR ASSOCIATION,
Detroit, Mich., June 11, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing on behalf of the Detroit Bar Association in support of Senate Bill S. 1039 which if passed into law would make permanent the inclusion of Section 120 in the Internal Revenue Code.

As proponents of prepaid legal service plans, we believe Section 120 should remain as part of the Code so that contributions to and the value of prepaid legal services will not be taxable to an employee under such a plan, thus placing group legal plans roughly on the same basis as group medical plans.

We appreciate your efforts in this matter and we will be happy to assist or provide any information we can concerning prepaid legal services in the Detroit area.

Sincerely yours,

ROBERT G. RUSSELL, *President.*

WESTCHESTER COUNTY BAR ASSOCIATION,
White Plains, N.Y., June 8, 1981.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR PACKWOOD: Our County Bar Association for many years has been interested in the concept of prepaid legal services. We have adopted our own plan which calls for an open panel. Due to the technicalities in the New York State law, which all of the bar associations have been trying to change, insurance companies have not been able to underwrite such plans in this State. We are about to launch our own plan in a modest fashion. We believe it is essential for the future viability of such plans that Section 120 of the Internal Revenue Code be extended beyond the present expiration period.

This letter is to indicate our strong support of S. 1039 to make Section 120 permanent.

Sincerely yours,

MARTIN DRAZEN, *President.*

ALASKA BAR ASSOCIATION,
Anchorage, Alaska, June 10, 1981.

Re Senate bill 1039.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Alaska Bar Association supported the legislative effort in 1976 to secure congressional adoption of an amendment to the Internal Revenue Code to facilitate the growth of pre-paid legal service plans. We realize that in order to secure the adoption of the provision, it was given only a five (5) year life during which Congress was to review the impact of this provision and determine whether to extend it further. The provision will expire December 31, 1981 unless Congress acts affirmatively to extend the life of Section 120 of the Tax Code.

The Alaska Bar Association is appreciative to you as the principal proponent of the 1976 amendment for introducing S. 1039 to make section 120 a permanent section of the Tax Code.

At the Board of Governors meeting in June, 1981, the Alaska Bar Association again passed a resolution urging that section 120 of the Tax Code be a permanent provision. We urge a passage of S. 1039 and by carbon copy of this correspondence are so advising our congressional delegation from the State of Alaska.

Very truly yours,

KAREN L. HUNT, *President.*

CITY OF COLUMBUS, OHIO,
June 12, 1981.

Re S. 1039 prepaid legal benefits.

Hon. ROBERT PACKWOOD,
Chairman, Subcommittee on Taxation and Debt Management, Committee on Finance, Russell Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Please accept these comments as an endorsement of your efforts to re-enact Internal Revenue Code Section 120(c).

The City of Columbus has provided Ohio Legal Services Fund prepaid legal benefits to its employees since 1975. In the judgment of this Administration, these low cost benefits have provided an outstanding return in increased productivity and employee retention.

One of the most heart breaking and frustrating problems faced by today's supervisors is the loss of services from trained workers who, while otherwise capable, are unable to financially or emotionally cope with demands of legal problems. We have found that the availability of legal services has allowed employees to survive the distress of domestic relations problems, debtor/creditor situations, consumer contract disputes and a wide range of non-civil defense needs.

In addition to keeping many of these trained employees on the job, productivity losses from preoccupation with their families' legal problems has been minimized by having legal representation available.

There is no way, of course, to assess the impact of preventive legal work in the writing of wills, the advice of counsel in real estate transaction and the availability of legal consultation. We surmise from benefit utilization data that these services have allowed many employees to address potential legal problems before incurring substantial liabilities.

Retention of Internal Revenue Code Sections 501(c)(20) and 120(c), Senator Packwood, would be a service to American workers and the industries in which they work. Prepaid legal benefits, in my opinion, should be encouraged because of their positive effect on productivity and the current need to protect employee income.

Sincerely,

TOM MOODY, *Mayor.*

THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK,
New York, N.Y., June 17, 1981.

Re S. 1039—to make the exclusion of amounts received under a qualified group legal services plan permanent.

Hon. BOB PACKWOOD,
U.S. Senate, Committee on Finance,
Washington, D.C.

DEAR SENATOR PACKWOOD: The Association of the Bar of the City of New York supports the proposal which you introduced in the Senate to make permanent § 120 of the Internal Revenue Code. Section 120 provides that employers' contributions to qualified group legal services plans, and the value of the legal services provided, are exclusions from employees' income. Unless extended, the exclusion provided by this law will expire on December 31, 1981.

S. 1039, the bill which you introduced, would make the exclusion in § 120 of the Code a permanent one and we hope that such a bill will be enacted into law.

The availability of legal services to persons of all income levels is of fundamental importance. It is essential to fulfill the principle of "equal justice under law."

By providing for the exclusion of amounts received under qualified group legal services plans, § 120 has contributed to the development of these plans and to the goal of making legal representation available to all persons who need it. The report of the Senate Finance Committee on the bill which became § 120 said, "The committee believes that excluding such employer contributions from the employees' income will promote interest in such plans and increase the access to legal services for many taxpayers by encouraging employers to offer and employees to seek such plans as a fringe benefit." S. Rep. No. 94-938, 94th Cong., 2d Sess., at 38 (1976), reprinted in 1976 U.S. Cong. & Ad. News 4030, 4064. We believe that experience since then bears this out.

Access to legal services for the very poor, who may not be employed (and thus unable to benefit from § 120) must be met in some other way. To that end this Association, as you know, supports the legislation now pending before Congress to reauthorize the Legal Services Corporation, which provides grants to local offices for the provision of free legal services to the poor.

But legal representation must also become more widely available to middle-income persons. Indeed, the Senate Committee reporting § 120 found that:

"A tax incentive, which would increase the availability of legal services, is especially helpful to middle-income taxpayers who at present may be the most underrepresented economic group in terms of legal services. Lower income persons have access to publicly-supported legal aid services, while taxpayers with higher incomes can generally afford their own legal expenses." Id. at 4064.

We respectfully urge that the Congress make § 120 of the Internal Revenue Code permanent, as S. 1039 would do, and reauthorize the Legal Services Corporation. Both steps will contribute importantly toward the national goal of providing meaningful access to the courts and to the judicial system for all Americans.

Sincerely yours,

OSCAR M. RUEBHAUSEN, *President.*

DENTSPLY INTERNATIONAL,
York, Pa., June 1, 1981.

Hon. JOHN DANFORTH,
U.S. Senate,
Washington, D.C.

DEAR SENATOR DANFORTH: I wish to express my thanks to you for introducing Bill S. 978, which would relieve employers of the requirement to provide W-2 forms to employees at the time of termination, unless the employee specificaly requests the W-2 form. We have found the present regulations requiring us to provide terminating employees with a form W-2 within 30 days of the date of termination to be burdensome and unnecessary. Frequently the employee loses his W-2 prior to filing his tax return and subsequently requests another W-2 from us. From an administrative standpoint, we have to manually prepare the W-2 form because the computer is programmed to prepare the W-2 form only for all employees. Then after the end of the year, the computer automatically prepares another W-2 form which has to be manually pulled to avoid duplicate mailing of a W-2 form to the employee.

Thanks again for your efforts to reduce our paperwork load.

Sincerely,

MARCUS K. DIXON,
Assistant Treasurer and Tax Manager.

JENKINS, NYSTROM & STERLACCI, P.C.,
Washington, D.C., May 5, 1981.

Re support of S. 978

ROBERT E. LIGHTHIZER, Esq.,
Chief Counsel, Committee on Finance,
Washington, D.C.

DEAR MR. LIGHTHIZER: On behalf of the Retail Bakers of America, national association of this country's 30,000 retail bakers who make and sell on their own premises and in their own neighborhoods hundreds of hand-crafted and morning-fresh bakery foods every day, I am pleased to express support for S. 978, a bill to permit employers to provide W-2 forms for terminated employees at year-end.

Most retail bakeries are family owned and operated businesses which employ five to fifteen persons. Many employees are young people, some of whom are fulltime high school students. Retail bakeries do not have fulltime bookkeepers, "personnel directors" or "payroll departments". Usually, the baker himself or his spouse keeps the books and makes out payroll checks. At the same time, due to the youth of employees and their circumstances, there is a fair amount of turnover in the typical bakery.

For these reasons, it is obviously advantageous to the members of our industry to be permitted to furnish terminated employees a W-2 form at the end of the year rather than upon termination. This way, the baker can take care of the matter for various employees at the same time and for all, instead of having to incur a paperwork burden each time an employee leaves.

At the same time, such a change in the law would in no way prejudice, disadvantage or inconvenience former employees, since they would only need these forms for tax purposes and since everyone files a return on the same date. In fact, the change would actually benefit employees, who would not have to worry about safekeeping and no losing the forms until needed, and who would not have to go to the trouble of requesting a duplicate form in the event they lose the original W-2 that they received upon termination.

As a means of lessening the paperwork headaches of small retail bakers, therefore, and at the same time perhaps saving some former employees some inconvenience too, the Retail Bakers of America supports passage of S. 978.

If you have any questions concerning RBA's position on this legislation not answered by this statement, please telephone me.

Respectfully submitted,

GERARD P. PANARO,
General Counsel, Retail Bakers of America.

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