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EMPLOYMENT AND INCOME TAX AMENDMENTS

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EMPLOYMENT AND INCOME TAX AMENDMENTS

1. *Employee status of fishermen (proposed by the Treasury Department, sec. 210 of the Social Security Act and secs. 3121 and 3401 of the code)*

Present law.—The liability for social security taxes on wages (FICA), is imposed with respect to each "employee," and that term is defined (sec. 3121(d) of the code) as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." * * * These same rules are generally applicable for income tax withholding purposes. The FICA taxes are not imposed with respect to a worker who is regarded under the common law as an independent contractor. However, an independent contractor would be subject to the tax on self-employment income.

Problem presented.—For more than a decade both the Internal Revenue Service and the Social Security Administration have held that fishermen employed on fishing vessels are common law employees and, therefore, are subject to the payment of FICA taxes and income tax withholding. However, the classification of these workers as employees rather than as independent contractors involves what is essentially a factual question, and, as a result, has produced widespread litigation and considerable confusion. The court interpretations have been inconsistent to the extent that some have held that such persons are independent contractors not subject either to the FICA taxes or income tax withholding, while other persons performing essentially the same functions under the same circumstances have been held to be employees subject both to these taxes and to income tax withholding. The Treasury Department has indicated that there are over 150 cases pending that involve the question of the employment status of fishermen.

The result has been that competing firms employing individuals under essentially similar circumstances bear unequal social security tax burdens. The purpose of the amendment is to equate the social security tax burdens of these competitors, and to relieve the courts and the Government of the caseload the present confusion has produced. In addition, the amendment would result in collection of income taxes through withholding which are unlikely to be collected in any other way.

Change made by proposed amendment.—The amendment would classify fishermen as "employees" rather than as independent contractors for social security and income tax withholding purposes. Thus, it would no longer be necessary to apply common law rules to determine the status of these workers, and their employers would be liable for the social security taxes and for income tax withholding on the compensation that they pay.

In general, the amendment would classify the owner of a fishing boat as the employer of the boat's crewmembers unless the owner has leased the boat to another under a charter under which the owner has no interest in the catch and the lessee does. Where these conditions are both present, the lessee would be classified as the employer.

The social security benefit amendments made by this provision are retroactive and are designed to make it clear that fishing has constituted covered employment for social security benefit purposes as if the amendments had been part of the Social Security Act from 1951 on. For purposes of the tax liability in instances where this liability does not presently exist, the amendment applies with respect to remuneration paid after December 31, 1967, for services performed after that date.

Treasury Department position.—The Treasury Department proposed this amendment.

2. Employee status of truck loaders and unloaders (proposed by the Treasury Department, sec. 210 of the Social Security Act and secs. 3121 and 3401 of the code)

Present law.—The liability for social security taxes on wages (FICA) is imposed with respect to each "employee," and that term is defined (sec. 3121(d) of the code) as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. * * * " These same rules are generally applicable for income tax withholding purposes. The FICA taxes are not imposed with respect to a worker who is regarded under the common law as an independent contractor. However, an independent contractor would be subject to the tax on self-employment income.

Problem presented.—The problem with respect to truckloaders and unloaders, commonly called "gypsy chasers," is almost identical to that explained in No. 2 above with respect to fishermen. For years, both the Internal Revenue Service and the Social Security Administration have held that truckloaders and unloaders are common law employees and therefore subject to the payment of FICA taxes. However, the classification of these workers as employees, rather than as independent contractors, involves what is essentially a question of fact, and as a result, has produced widespread litigation and considerable confusion. The court interpretations have been inconsistent to the extent that some of these workers have been held to be subject to the FICA taxes while others performing essentially the same functions under the same circumstances have been held to be independent contractors not subject to these taxes. Generally, if a worker is determined not to be an employee for FICA tax purposes, the employer also fails to withhold the income tax on the compensation he pays to them. A number of cases involving truckloaders and unloaders dealing with this problem are pending before the courts.

The amendment is designed to obtain uniformity in the treatment of these workers and to relieve the courts and the Government of the caseload the present confusion has produced. In addition, the amendment would result in collection of income taxes through withholding which are unlikely to be collected in any other way.

Change made by proposed amendment.—The amendment would classify persons who load or unload the contents of a truck as employees for purposes of the FICA taxes and income tax withholding no matter what the common law status of such persons may be. The amendment would make it unnecessary to determine the employee status of these persons under the common law rules. Under the amendment, the driver in charge of the truck that is loaded or unloaded is considered the employer of the person who loads or unloads it unless the truck-driver is himself an employee of another person. In that case, the truck-driver's employer would be considered to be the employer of the loader or unloader. However, where a third person furnishes the truckdriver (or his employer) with a written acknowledgment that he is the employer of the unloader, the third person will be so considered for FICA tax and income tax withholding purposes. Thus, for example, where loaders and unloaders are furnished by a warehouse and the warehouseman acknowledges in writing that he is the employer of these persons, the warehouseman and not the truckdriver, or his employer, will be considered to be the employer of the unloaders. The amendment would also amend the income tax wage withholding provisions to make it clear that employee status determined under these new rules will also be applicable for that purpose.

The social security benefit amendments made by this provision are retroactive and are designed to make it clear that truck unloading constituted covered employment for social security benefit purposes as if the amendments had been part of the Social Security Act from 1951 on. For purposes of the tax liability in instances where this liability does not presently exist the amendment applies with respect to remuneration paid after December 31, 1967, for services performed after that date.

Treasury Department position.—The Treasury Department proposed this amendment.

3. Deduction of medical expenses for taxpayers and their dependent parents who have attained the age of 65 (amendment No. 278 by Senator Byrd of West Virginia (for Senator Smathers) to sec. 213 of the Code)

Present law.—The Social Security Amendments of 1965 amended the medical expense deduction provision of the Internal Revenue Code (sec. 213) to delete several special rules applicable with respect to persons age 65 or over. In general, medical expenses are deductible only to the extent they exceed 3 percent of the taxpayer's adjusted gross income. Similarly, the cost of medicines and drugs are treated as medical expenses only to the extent they exceed 1 percent of the taxpayer's adjusted gross income. Prior to the 1965 amendments, these 3- and 1-percent floors did not apply with respect to the medical expenses of dependent parents of a taxpayer or his spouse if the parents were age 65 or over. In addition, these floors did not apply to the medical expenses of the taxpayer himself or of his spouse if they were age 65 or older. The 1965 amendments made the floors applicable to the medical expenses of these older persons for 1967 and later years.

Problem presented.—Many older persons are either dependent on their children for much of their support, or if self-supporting, live on fixed incomes the purchasing power of which is continually eroding as prices rise. At the same time, these older persons are the ones most prone to incur large medical expenses. In view of these considerations and the fact that for many years before 1967 older persons were not

subject to the 3- and 1-percent floors on medical expenses, the proposal would remove these restrictions for those age 65 or over.

Change made by proposed amendment.—The amendment would make the medical expenses of dependent parents of a taxpayer, or his spouse, if the parents were age 65 or over, and those of a taxpayer himself, or his spouse if age 65 has been attained, deductible without regard to the 3- and 1-percent floors. The effect of the amendment is to reinstate the exceptions to the application of these floors that existed before the Social Security Amendments of 1965, for 1967 and later years, thereby making the 1965 amendment completely inoperative for any year.

Treasury Department position.—The Treasury Department opposes this amendment. Their reasons can be summarized as follows:

(1) The amendment would result in a significant revenue loss estimated to be about $210 million annually.

(2) The major beneficiaries of the amendment would be taxpayers in the higher income groups. The Treasury states that 45 percent of the relief would go to those with adjusted gross income over $50,000 and 70 percent would go to those with adjusted gross incomes of $20,000 or over.

(3) The 1965 act that made the floors applicable to these older citizens also provided the "medicare" program. The supplementary benefit payments to cover part of doctors' fees are paid for half by the person involved and half by the Government. The provision for applying the medical expense floors in 1965 was thought of as a substitute for requiring those with higher incomes to pay the total cost of the supplementary benefit payments.

Staff comments.—Provisions designed to accomplish the objectives of this amendment have been passed by the Senate on two occasions, once in the 1965 act itself, and again in the Foreign Investors Tax Act of 1966. On both occasions the provision has been deleted in conference at the insistence of the House conferees.

4. Deduction of medical expenses of certain relatives who have attained age 60 (amendment No. 306 by Senator Smathers, sec. 213 of the code)

Present law.—Under present law, income tax deductions are permitted (subject to certain limitations) for the medical care of a "taxpayer, his spouse, and dependents." For these purposes, a dependent is a person related to a taxpayer, or a member of his household, who receives more than half of his support for the year from the taxpayer.

Problem presented.—The proposal is the result of the study by the Senate Special Committee on Aging of the problems of older citizens. A report of this committee indicates that tax concessions to taxpayers who contribute to the support of needy older relatives are desirable because they will stimulate increased contributions from younger family members to older family members and will eliminate tax discrimination against taxpayers who contribute less than half of the support of older family members. The report also indicates that this change would be an efficient alternative to public expenditures and promote desirable social objectives. This amendment is recommendation No. 3 of that committee as shown in its report of October 13, 1966 (Senate Rept. No. 1721, 89th Cong., second sess.).

Change made by proposed amendment.—The amendment would permit a taxpayer to include, in computing his medical expense deduction, payments of medical expenses for a relative—or a non-

relative who is a member of the taxpayer's household—who is over 60 years of age, and who has less than $1,200 of gross income during the year. Thus, the taxpayer would be entitled to claim such amounts as medical deductions whether or not he otherwise contributed during the year to the support of such a relative (or other person if living in his household).

Treasury Department position.—The Treasury Department is opposed to this amendment. Its opposition is based on the following reasoning:

(1) There is a revenue loss of approximately $50 million involved in this proposal.

(2) This proposal departs from the principle that medical expense deductions may be claimed only for dependents.

(3) In effect this opens up the way to claim any amounts given to relatives as deductions merely by using these amounts to pay their medical expenses.

The Treasury has indicated, however, that it would not object to a proposal which would permit the deduction of medical expenses which are paid with respect to a person who has attained the age of 65 and who is a dependent under a multiple support agreement if the payments are made by a taxpayer who is a part of the group making the multiple support payments and who contributes at least 10 percent of the support of the dependent.

5. Increase in limit on retirement income credit (amendment No. 373 by Senator Smathers to sec. 37 of the code)

Present law.—The credit for retirement income allowed against the individual income tax is designed to provide a tax benefit for retired individuals receiving income other than in the form of social security payments approximately equal to the benefit of the exclusion of social security benefits from income. Subject to conditions which are substantially similar to the provision for social security benefits, the law provides a tax credit for retirement income but only to the extent that the individual does not receive the benefit of an exclusion from income tax of social security payments. Present law (sec. 37(d) of the code) limits the amount of income eligible for this retirement income credit to what in the past has been the maximum social security benefit. Currently this limitation is $1,524 a year or 1½ times this amount ($2,286) for married taxpayers where they both are not independently eligible for the full $1,524 amount.

Problem presented.—At the time the retirement income credit was enacted in 1954, the limitation on retirement income eligible for the credit was $1,200, then generally the maximum social security benefit. Social security benefits were increased in 1962 and later in that same year the credit was amended to restore this relationship of retirement income eligible for the credit with the maximum social security benefits by increasing the maximum retirement income for credit purposes to the present $1,524 (or, subsequently, $2,286 for certain married couples). The limitation was not raised in 1965 when social security benefits were again increased and to date has not been increased to correspond to the social security benefits proposed in the bill currently under consideration.

Change made by proposed amendment.—The amendment would increase the limitation on retirement income eligible for the credit to $2,268 or to $3,402 (1½ times $2,268) for married taxpayers where

they are each not independently eligible for the full $2,268. The maximum income level of $2,268 a year on which a credit would be allowed is based upon an average monthly wage of from $549 to $552 a month. This is the level at which a primary benefit of $189 would be provided under the bill.

Treasury Department position.—The Treasury has indicated that it opposes this amendment in its entirety. The Treasury Department proposed to the House Committee on Ways and Means a new special deduction for the aged of $2,300 for single persons over age 65 or $4,000 for married couples over age 65 but with limitations above specified income levels. This special deduction would be available without regard to whether the individual past age 65 was covered by social security or was employed. This would be a substitute for the retirement income credit, the special $600 exemption for those over age 65, and for the social security income tax exclusion. The Treasury Department believes that if any action is taken with respect to the retirement income credit, it should be taken along the lines of its proposal to the House Committee on Ways and Means.

Staff comments.—Should the committee desire to consider raising the limitation on the retirement income credit in connection with this bill, there are problems with the maximum provided by this amendment. The primary benefit of $189 per month on which the $2,268 is based (12 times $189) is derived from an average monthly wage which cannot be reached by a person retiring at age 65 until 26 years in the future. This occurs because of the method of computing the average monthly wage under existing law and under the bill. In general terms the average monthly wage is the wage received in each of the years up to retirement since 1950 (or the year the retiree became age 21 if later), eliminating the wage in the lowest 5 years.[1] For example, for an individual retiring at the end of 1967, his average monthly wage would be computed on the basis of his wage in the last 17 years, eliminating 5 of these years with the lowest wage. Because the maximum wage base has been increased from the level of $3,600 in the years 1951 to 1954, to $4,200 in the years 1955 through 1958, to $4,800 in the years 1959 through 1965, and to $6,600 in 1966,[2] a primary benefit cannot reach the maximum until it is calculated largely upon the larger wage base of $6,600, or $7,600 as proposed by the House version of the bill under consideration. The level of $189 as a primary benefit under the bill for a person retiring at age 65 will not become applicable until the year 1993. Because of this, if a change is to be made in the limitation for the retirement income credit, it would appear more appropriate to increase this to the maximum level currently available for an individual retiring at age 65. This is $159.80 a month, or $1,917 on an annual basis.

This amendment, based upon the income level specified in the amendment as submitted, would involve an annual revenue loss of approximately $170 million. If the amount were increased to the income level of $1,917 the annual revenue loss is estimated at $80 million.

[1] The computations are actually made on a monthly basis but an annual wage is used here for ease of illustration.

[2] The House bill raises the wage base to $7,600 for 1968 and later years.

6. Wage base for social security tax purposes in the case of affiliated groups of corporations (amendment to sec. 3121(a)(1) of the code)

Present law.—Social security taxes are imposed on wages of employees up to a stated dollar maximum. Under present law, this wage base is $6,600. Under the bill, the wage base would be increased to $7,600 for 1968 and later years. If an employee receives wages from more than one employer during a year, each employer is subject to the employer tax to the extent of the wages it pays a particular employee up to the dollar maximum.

Problem presented.—Since the maximum annual limitation applies to each employer separately, the employer tax with respect to an employee who performs services for various members of an affiliated group of corporations during a year is computed and paid by each affiliated corporation on wages it pays the employee up to the maximum dollar limitation (currently $6,600). This results in a larger amount of tax being paid by these related employers than would be the case if the dollar limitation were applied to the members of the affiliated group cumulatively.

Change made by proposed amendment.— The proposal would amend the code (sec. 3121(a)(1)) to provide that members of an affiliated group may take into account wages previously paid by other members of the group to an employee for purposes of determining its liability for social security taxes on wages paid to the employee within the $6,600 wage base.

Treasury Department position.— The Treasury Department takes no position in this matter.

HEW position.—The Department of HEW opposes this amendment on the basis that the employer tax is imposed for purposes of funding the social security program and is not directly attributable to any one employee. If this concept is accepted, it can be viewed as proper to impose the tax with respect to separate employers on a separate basis. Moreover, if this provision were to be adopted for affiliated groups of corporations, the Department believes it might be viewed as a precedent for extending the same provision to two or more employers of a single employee who are not affiliated. The extension of this provision to employers which are not affiliated would create serious administrative problems.

Staff comments.—This same amendment was added by the Finance Committee to H.R. 6675, the Social Security Amendments of 1965, but the amendment was not accepted by the House in conference.

7. Wage base for social security tax purposes in the case of certain nonprofit organizations (amendment to ch. 25 of the code)

Present law.—Social security taxes are imposed on wages of an employee up to a stated dollar maximum. Under present law this wage base is $6,600. Under the bill the wage base will be increased to $7,600 for 1968 and later years. If an employee receives wages from more than one employer during a year each employer is subject to the employer tax to the extent of the wages he pays the employee within the dollar limitation.

Problem presented.—The problem has arisen in connection with the employer tax liability of the Blue Cross and Blue Shield plans. Blue Cross and Blue Shield are organized on a local basis throughout the country and are usually separate legal entities in each locality.

Generally Blue Cross was organized first and Blue Shield, when later organized, contracted with Blue Cross to provide the services, such as clerical services, involved in the performance of its functions.

The Internal Revenue Service in the case of the Oklahoma and Kansas Blue Cross and Blue Shield organizations has taken the position that the employees who furnished the services both to Blue Cross and to Blue Shield are joint employees of both companies. This results in additional employer taxes on up to $6,600 of wages where the employee has wages over this amount.

In the Oklahoma and Kansas cases the chief officers are officers of both the Blue Cross and the Blue Shield companies. This is true of the executive director and some of the other directors in the case of the Kansas companies and of the president and secretary-treasurer in the case of the Oklahoma companies. However in both States the two companies involved maintain separate bank accounts, all operating expenses (including all payments of salaries) in both cases being initially paid by Blue Cross and then Blue Cross being reimbursed by Blue Shield on a monthly basis for its share of the expenses. In each case the Blue Cross company has the right to hire and fire the employees (except in the case of those officers appointed by both companies). Both companies operate under operating agreements which specify that Blue Shield is to reimburse Blue Cross for expenses incurred on a monthly basis. In the case of the Kansas companies the expenses allocable to each are based upon the claims processed while in the case of Oklahoma they are based upon the contracts in force.

There are additional ramifications to treating Blue Cross and Blue Shield as being joint employers. The definition of an employee used in the employment tax provisions is also applicable for the purpose of establishing qualified pension plans. Currently the employees in question are covered by pension plans established by Blue Cross. If they are considered to be joint employers it will be necessary to substantially modify the existing pension plan structure and this may result in reduced pensions.

Change made by proposed amendment.—The proposal would add a new section to the Internal Revenue Code (sec. 3506). The new section would provide that in cases such as the Blue Cross-Blue Shield situation described above, if both entities are tax-exempt organizations the Treasury Department is authorized upon the request of the organizations to designate which is to be considered the employer for purposes of the employment taxes and pension plans.

Staff comments.—It would appear possible to handle this problem administratively by considering Blue Cross the "employer" who simply contracted with Blue Shield for certain work. The Internal Revenue Service has not as yet, however, indicated that it believes that this can be done.

8. *Time for filing applications for exemption from self-employment tax by Amish (amendment proposed by the Treasury Department to sec. 1402 (h) (2) of the code)*

Present law.—The Social Security Amendments of 1965 provided that members of religious sects who conscientiously oppose certain types of insurance in accordance with an established tenet of the sect may elect exemption from the self-employment tax. This provision was adopted on behalf of the Amish who oppose the acceptance of benefits of any private or public insurance which makes payments in the event of death or disability, old-age, or retirement, or makes payments toward the cost of medical care.

Generally, applications for exemption were required to be filed on or before April 15, 1966, in the case of those taxpayers first deriving self-employment income for 1964 or any prior year. Taxpayers first deriving self-employment income in 1965 or any subsequent year are required to file applications on or before the due date (including any extension) of the income tax return for such first year.

Problem presented.—At least 164 taxpayers are known to have filed applications for exemption from the self-employment tax which cannot be approved because they were filed after the date required by the statute. In addition it is believed that there are other qualified persons who desire to file applications but failed to do so within the prescribed period. The Internal Revenue Service will be required to proceed to collect self-employment taxes from these taxpayers by levy on their bank accounts or seizure of their other property unless the law is amended to allow more time for filing the applications.

Change made by proposed amendment.—The amendment would permit the filing of an application for exemption by December 31, 1968, if the person has self-employment income for years ending before December 31, 1967. If a person first received self-employment income in later years, as under present law, the application would be timely if filed by the due date for the income tax return for the year. However, in these latter cases, the amendment also provides that the application is timely if filed within the 3 months following the month in which the person is notified in writing by the Internal Revenue Service that a timely application has not been filed.

Treasury Department position.—Treasury Department proposed and favors enactment of this amendment.

9. *Location of parents who desert or abandon dependent children; establishment of liability to United States (amendment by Senator Long of Louisiana, sec. 402 of the Social Security Act and sec. 6305 of the code)*

Present law.—One of the objectives of the present public assistance law is to encourage parents of children who are receiving aid for dependent children to live up to their responsibility to support the children to the extent possible. To aid in this objective, present law provides for cooperation between the Department of Health, Education, and Welfare and the appropriate local welfare and law-enforcement officials. These provisions are strengthened by amendments included in the bill as passed by the House. This strengthening is accomplished in two ways. First, the bill would broaden the exceptions to the prohibition against disclosure of social security information by the Department to make the address of an individual and the address of his employer, available to a court for its use in issuing child-support orders. In addition, the bill would permit local welfare agencies to enter into agreements with local law-enforcement officers and courts under which welfare funds would be used to defray the costs of pressing child-support claims against parents.

Problem presented.—Despite the provisions of present law and the House bill, the problem of obtaining support from fathers for their dependent children appears to be almost impossible in those cases where the whereabouts of the father is not known. In addition, in cases where the father's address is known, the workload of the local courts

and law-enforcement officials is frequently such that enforcement of the obligation for support is sometimes not pressed with the necessary vigor. Thus, there are two aspects to the problem: first, the location of fathers who have abandoned their children; and, second, the obtaining and enforcement of court orders requiring the fathers to contribute toward the support of their children. There are approximately 800,000 fathers of children who are receiving aid who are absent from the homes in which the children reside. Of this number, it has been estimated that there are about 40,000 fathers against whom court support orders have been entered who cannot be located. An additional 60,000 fathers against whom no court order has been obtained cannot be located.[1]

The amendment would adopt a new approach to increase the proportion of fathers of children, with respect to whom payments under the AFDC program are being made, who contribute to the support of these children to the extent of their ability.

Change made by proposed amendment.—The proposal would attack both aspects of the problem: the location of the absent father; and the enforcement of the obligation to support once he is located.

The first step of the proposal provides that the appropriate State welfare agency is to submit to the Secretary of HEW a list of fathers who cannot be located and against whom an order for support has been issued or a petition for support has been filed. HEW then is to furnish the names to the Internal Revenue Service, together with other available information, such as social security account numbers, etc. The Service in turn is to attempt to ascertain the current address of the fathers from its master file of taxpayers and furnish them to the State agency. It is thought that by this procedure many of the fathers who have not been located under the existing procedures will be found.

The second step of the proposal would implement the collection of court support orders that have been issued where the father resides in a different State than the one in which the child resides. If such an order has been issued, and the father is not in compliance, or in good faith partial compliance, the State agency is to attempt to obtain compliance with the order to the extent of the father's ability. In attempting to obtain compliance, the State agency is expected to inform the father that in the event he does not comply, his liability will be established and collected by the Internal Revenue Service.

If the State agency is unable to secure compliance, it will report the name of the father to the Department of Health, Education, and Welfare, along with other information bearing upon the ability of the parent to furnish support. On the basis of this information and any other information it may have, the Department will determine whether or not the parent is able to make support payments, or larger support payments than he has made. In so doing, the Department will take into account the income of the parent and his current obligations.

If the Department of Health, Education, and Welfare determines that a parent is capable of making payments, it will certify to the Internal Revenue Service the amount which the parent is able to pay. The amount certified may not exceed the Federal contribution (determined on a general percentage basis for the State) of the aid payments being made because of the dependent child, or the amount the father would be required to pay under the court order whichever is less. Upon receipt of a certification from the Department of Health, Education, and Welfare, the Internal Revenue Service is to assess and collect the amount certified in the same manner as it does income taxes withheld and employment taxes (except that the interest and penalties do not apply); that is, by the issuance of a notice and demand for payment and the use of the regular tax collection procedures, including levy and distraints if payment is not received within 10 days.

[1] The figures of 40,000 and 60,000, although an accurate indication of the scope of the problem, are only informed estimates. They are based upon past studies and the experience of HEW personnel who have dealt with the problem for many years and are the best estimates available.

The amendment authorizes the payment of the costs involved to the Internal Revenue Service in aiding in the location of the fathers and for the Service's cost in the new collection procedure. The expense to the Internal Revenue Service of these procedures is to be reimbursed to the Internal Revenue Service by the Department of Health, Education, and Welfare.

This amendment is to be effective as of January 1, 1969, with respect to amounts expended as aid to families with dependent children during periods beginning on or after April 1, 1968.

HEW position.—The Department of Health, Education, and Welfare does not object to this amendment.

10. Tax-exempt status for entities organized to perform services for tax-exempt hospitals (S. 2315 by Senators Metcalf and Carlson to sec. 501(c) of the code)

Present law.—If two or more tax-exempt hospitals join together in creating an entity to perform services or other functions for the hospitals, the Internal Revenue Service takes the position that the entity constitutes a "feeder organization" and is not entitled to tax exemption because of a special provision of the code applicable to such organizations. This is true even though the service or function performed, if performed by each of the hospitals individually would be considered an integral part of their exempt activities. In spite of this position of the Service, the leading case in point held such an entity furnishing services to hospitals to be exempt from tax.[1]

Problem presented.—A number of hospitals have formed organizations to perform various services such as data processing, diagnostic laboratory services, laundering, purchasing, and recordkeeping, etc. for the hospitals as a group. In addition, others desire to form such organizations. It is pointed out that performing services and functions such as these in a joint operation can be expected to keep down the cost of hospital care. In some instances, tax-exempt charitable foundations have expressed a desire to make grants to finance the creation of the service entity. These charitable foundations, however, are reluctant to make the grants to the service entity unless it itself is exempt from tax under section 501(c)(3) because they fear so doing would jeopardize their own exempt status. Similarly others making gifts to enable the building of these joint facilities would not, under existing law, be eligible to claim a charitable contribution deduction for these amounts. Even if the contributions were made directly to the hospitals with the understanding that the funds would be used for these joint facilities it might be that the charitable contribution deduction would be denied.

Tax-exempt status for the service organization is desired for an additional reason. In determining exemptions from State and local

[1] *Hospital Bureau of Standards and Supplies, Inc.*, v. *United States*, 1 AFTR 2d 633 (1958) 158 F. Supp. 560, U.S. Court of Claims.

taxes, many State and local governments rely upon the existence of an exemption from Federal income tax. Consequently, if tax-exempt status under the Federal income tax laws is granted to these organizations, it will in some instances make it possible for the organization to obtain exemption from State and local taxes.

Change made by proposed amendment.—The amendment would provide that an organization, all the members of which are tax-exempt hospitals or governmentally owned hospitals and which also meets the requirements for tax-exempt status under section 501(c)(3) of the code, is itself exempt from tax. This exemption would only apply, however, where activities performed by the organization are performed only for the tax-exempt hospitals and then only if they are of such a nature that if performed by the hospitals individually they would be considered an integral part of their tax-exempt function.

This amendment applies to taxable years ending after the date of enactment of the bill.

Treasury Department position.—The Treasury Department has indicated that it would not object to the proposal if it were modified in the manner suggested in the staff comments below.

Staff comments.—It has been suggested problems may arise where the treatment described above is extended to products (such as drugs) as distinct from services rendered by the joint enterprise. Since it apparently is services for which the joint enterprises are to be used, it would appear desirable to limit the exemption to joint services. Questions have also been raised as to whether one hospital might make a "profit" on one of these joint enterprises at the expense of the others. To foreclose this possibility it is suggested that the exempt status be limited to those joint enterprises organized and operated on a cooperative basis which allocate all of their net margins to the member hospitals on the basis of the use of the services. The revenue effect of this amendment would be negligible.

11. Refund of certain overpayments by employees of hospitals insurance tax (amendment by Senator Curtis to sec. 6413(c) of the code)

Present law.—If more than the maximum amount of social security tax (FICA) is withheld from an employee's wages, usually because he worked for two or more employers during the year, the excess may be claimed by the employee as a credit against his Federal income tax. The maximum FICA tax under present law is the tax on $6,600 of wages. However, if an employee had wages withheld by one employer under FICA and by another employer under the Railroad Retirement Tax Act, he is not entitled to a credit against his income-tax liability because the two acts provide for separate and distinct taxes and separate and distinct benefits are earned.

Problem presented.—As part of the Social Security Amendments of 1965, the hospital insurance benefits program was enacted and applies to all employees insured under either the social security or railroad retirement programs. The hospital insurance tax is paid as a part of the tax imposed under FICA and the Railroad Retirement Tax Act. Thus, although the employee taxes imposed by the two acts are separate and distinct, the hospital insurance tax paid as a part of these taxes is the same as it goes into the same trust fund to provide the same benefits. Therefore, when an employee has wages withheld by one employer under FICA and another under the Railroad Retirement Tax Act, he may pay the health insurance portion of the tax on

wages in excess of the $6,600 wage base and is not allowed a credit for the excess hospital insurance tax paid.

Change made by proposed amendment.— This proposed amendment would allow those employees who have employee taxes withheld under both FICA and the Railroad Retirement Tax Act to claim a credit against income tax for the excess hospital insurance tax paid. This would provide a credit to the employee for the hospital insurance tax paid in excess of tax payable on the $6,600 wage base.

Treasury Department position.—The Treasury Department does not object to this provision. It believes, however, that the provision of the Internal Revenue Code dealing with W–2 forms should be amended to require that the portion of the tax paid under the Railroad Retirement Tax Act, which is attributable to the hospital insurance tax, be specified on the form. This is necessary to inform the employee of the amount of his overpayment and consequently the credit he may claim against his income tax.

HEW position. —The Department of Health, Education, and Welfare does not object to this amendment.

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