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TAX-FREE STATUS OF SOCIAL SECURITY BENEFITS

JUNE 15 (legislative day, JUNE 1), 1981.—Ordered to be printed

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

REPORT

[To accompany S. Res. 87]

The Committee on Finance, to which was referred the resolution (S. Res. 87) with respect to taxing social security benefits having considered the same, reports favorably thereon with amendments and recommends that the resolution do pass.

I. SUMMARY

Under current law, social security benefits are exempt from Federal income taxes. Various groups, including the 1979 Advisory Council on Social Security and the President's Commission on Pension Policy, have recommended that all or part of such benefits be included in an individual's taxable income. Senate Resolution 87, introduced by Senator Heinz with 29 cosponsors, would express the sense of the Senate that the 97th Congress will not enact legislation which would change the tax treatment of social security benefits.

II. GENERAL DISCUSSION OF THE RESOLUTION

BACKGROUND

Social Security benefits are not explicitly precluded from taxation by statute, but derive their tax-exempt status from administrative rulings going back to 1938. Preceded by a Supreme Court decision (unrelated to the issue of taxability) in which social security was characterized as being for the "general welfare," Bureau of Internal Revenue rulings in 1938 and 1941 (I.T. 3194, I.T. 3229, I.T. 3447) held social security lump-sum and monthly benefits payments to be nontaxable.

12–012 O—83——1 (Pt. 1) BLR

The reasons behind the 1941 ruling (I.T. 3447), laid out in a letter from the Commissioner of the Bureau of Internal Revenue appearing in House Ways and Means Committee hearings published in 1954, included the following:

1. Following the reasoning of the Supreme Court, the benefits were viewed as being motivated by considerations of the general welfare, and such reasoning included elements necessary to bring the benefits within the scope of the section of the code exempting from taxation "the value of property acquired by gift. . . . "

2. Earlier rulings in 1938 that lump-sum payments made under certain sections of the Social Security Act were not taxable were not questioned when subsequent social security amendments were enacted, thus supporting the argument that Congress expected the tax status to remain unchanged.

3. Subjecting benefit payments to income taxation would tend to defeat the underlying purposes of the Social Security Act.

4. Congressional committee reports indicated that the Social Security Act was intended to attack the problems of insecurity by providing safeguards designed to reduce future dependency.

The 1941 ruling remains the basis for the tax-exempt status of OASDI benefits.

SUGGESTIONS THAT SOCIAL SECURITY BENEFITS BE TAXED

In its report on "Social Security Financing and Benefits," the 1979 Advisory Council on Social Security stated that "The council believes that this (1941) ruling was wrong when made and is wrong today. The right to social security benefits is derived from earnings in covered employment just as is the case with private pensions."

A majority of the council recommended that half of social security benefits be included in taxable income for purposes of Federal income taxes.

In support of its recommendations, the Advisory Council cited estimates by the Social Security actuary indicating that workers now entering covered employment in aggregate will make payroll tax payments totaling no more than 17 percent of the benefits that they can expect to receive. "Therefore, if social security benefits were accorded the same tax treatment as private pensions, only 17 percent of the benefit would be exempt from tax when received, and 83 percent would be taxable." The report notes, however, that because of a lack of data, taxing social security in the same way as private pensions "would be quite complicated. It would also result in taxing more of the benefit than most people would consider appropriate. Rough justice would be done, however, if half the benefit . . . were made taxable."

The report also noted that some members of the Advisory Council believe that taxation of benefits should not begin immediately and that some kind of gradual phase-in should be provided. Other members, according to the report, support the recommendation only if coupled with the adoption of other council recommendations. Three members of the council provided a supplementary statement expressing concern that this and other recommendations were adopted without adequate information for making an informed judgment as to their impact.

The final report of the President's Commission on Pension Policy, released on February 26, 1981, recommended that contributions to and benefits from social security receive the same tax treatment as other retirement programs. The Commission recommended that taxes on contributions to social security be deferred and benefits from social security eventually be counted as income subject to taxation. S. Res. 87 would declare that it is the sense of the Senate that such a proposal not be enacted.

ESTIMATED REVENUES UNDER THE RECOMMENDATION TO TAX ONE-HALF OF BENEFITS

Based on 1978 data, the Advisory Council estimated that its proposal for taxing half of social security benefits would affect 10.6 million tax filing units (with the highest taxable incomes) of the 24.4 million who receive social security cash benefits in that year. The average tax increase for those tax units which had an increase would be about $350, and the total increase in Federal tax collections would be $3.7 billion.

PRIOR ACTION

On May 15, 1980, on a 17–0 vote, the Committee on Finance reported a similar resolution, S. Res. 432, which stated that it was the sense of the Senate that no change in the tax treatment of social security benefits be approved by the 96th Congress. The Senate approved that resolution on August 4, 1980.

COMMITTEE RESOLUTION

Since the social security program was initiated, there have from time to time been proposals to modify the tax treatment of benefits. The committee has never approved such proposals in the past and it is the judgment of the committee that it will not approve any such proposals now. To assure that undue concern on the part of beneficiaries is not created by the recommendations of the Advisory Council or the President's Commission, the committee has reported this resolution which will affirmatively state that it is the sense of the Senate that no such change in the tax treatment of social security benefits will be approved by the 97th Congress. The amendments made to the resolution as referred are minor language changes and modifications of factual statements.

III. VOTE OF THE COMMITTEE IN REPORTING THE RESOLUTION

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote by the committee to report the resolution.

The resolution was ordered favorably reported by a voice vote.

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