

APPENDIX I

TAX-EXEMPT STATUS OF OASDI BENEFITS

Statement by Gerard M. Brannon, Director, Office of Tax Analysis, U.S. Treasury Department, at hearing before Special Committee on Aging, U.S. Senate, June 15, 1966 (p. 4 of Hearings Report) :

Social Security benefits were exempted from tax not by law but by revenue ruling on the theory that they were gifts—a theory inconsistent with the treatment of pension income and with the general view of OASDI as a contributory pension system. In the 1930's, it was still true, however, that the income tax applied only to the moderately high-income people; and it still did not make much practical difference whether Social Security payments were excluded. For both social security and railroad retirement, the usual tax rules would indicate that the recovery of the employee's own contribution should be tax free. For people retiring in 1966, this would at most result in about 89 percent of OASI benefits being included in income for tax purposes and 78 percent of railroad retirement benefits; that would be the result if they were treated like other kinds of pensions.

Statement by Hon. Stanley S. Surrey, Assistant Secretary of the Treasury for Tax Policy, at hearings before the Committee on Ways and Means, March 1, 1967 (p. 196 of Hearings Report) :

There is no sound principle that supports a complete exclusion for social security and railroad retirement benefits. These benefits are essentially in the nature of retirement income benefits and are comparable to those paid from a private retirement plan. The exclusion of social security retirement benefits is a tax anachronism granted administratively in the days when benefits were low, and the social security system was in its infancy and viewed as a "welfare" program. The exclusion of railroad retirement benefits was granted by a different committee to create parity of treatment with social security. To continue these exclusions as benefits grow will accentuate (1) the greater tax benefits given to the wealthy and (2) the arbitrary differences in tax treatment of elderly individuals with the same total incomes which now result from treating various kinds of income differently.

Opinion of Fred B. Smith, General Counsel of the Treasury Department filed with the Committee on Ways and Means, March 3, 1967 (pp. 374-377 of Hearings Report) :

Annuities under the Social Security Act, as amended, are not statutorily exempt from tax, as are comparable annuities under the Railroad Retirement Acts. However, the Internal Revenue Service has ruled, without discussion, that they are not subject to Federal income tax (I.T. 3447. C.B. 1941-1.191). But this ruling's position does not reflect any constitutional mandate, as an analysis of Revenue Ruling 66-34 reveals. * * * It has been suggested that social security benefits are "gifts or gratuities".¹

The Government so argued in *Helvering v. Davis*, which sustained the validity of the Social Security Act. But this argument was simply the logical corollary of the Government's theory of that case—that the Act involved the exercise of two separate and distinct powers, the taxing power and the power to spend for the general welfare. In other words, the taxes collected under title VIII were not earmarked to pay title II benefits. The Court upheld the act as a valid exercise of Congress' power to spend money in aid of the general welfare and its power to tax, against the contention that it violated the 10th amendment, but said nothing about the character of the benefits in the hands of the recipients. The decision has been cited many times in other court opinions, but never for the proposition

¹ The argument that social security benefits are gifts or gratuities seemingly ignores the fact that the social security system is financed entirely out of contributions via taxes by employers, employees and the self-employed. The fundamental concept of this program of social insurance has been that the individual contributes part of his earnings during his working life in order to keep receiving income during his retirement years as a matter of earned right rather than as a gratuity.