DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 5719, THE TAXPAYER ASSISTANCE AND SIMPLIFICATION ACT OF 2008

Scheduled for Markup
by the
COMMITTEE ON WAYS AND MEANS
on April 9, 2008

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's amendment in the nature of a substitute to H.R. 5719, the Taxpayer Assistance and Simplification Act of 2008, which is to be marked up by the Committee on Ways and Means on April 9, 2008.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 5719, the Taxpayer Assistance and Simplification Act of 2008* (JCX-28-08), April 9, 2008. This document can also be found on our website at www.house.gov/jct.

I. AMENDMENTS TO THE CHAIRMAN'S MARK

1. Health savings account substantiation requirement

Under the Chairman's amendment, substantiation of qualified medical expenses is effective for amounts distributed from health savings accounts after December 31, 2010.

2. Increase in information return penalties

The Chairman's amendment deletes the provision increasing the penalties for failing to file correct information returns, for failing to furnish correct payee statements, and for failing to comply with other information reporting requirements.

3. Increase in penalty for failure to file partnership returns

The Chairman's amendment deletes the provision increasing the penalty for failure to file partnership returns.

4. Penalty for failure to file S corporation returns

The Chairman's amendment deletes the provision increasing the penalty for failure to file S corporation returns.

II. ADDITIONAL PROVISION

1. Certain domestically controlled foreign persons performing services under contract with United States Government treated as American employers

Present Law

In general

Under the Federal Insurance Contributions Act ("FICA"), separate taxes are imposed on every employer and employee with respect to wages paid to such employer's employees.[2] These two taxes are commonly referred to as the employer's and the employee's share of FICA. The employee's share of FICA is collected by means of payroll withholding by the employee's employer.

For both the employer and the employee's share of FICA, the tax consists of two parts: (1) old age, survivor, and disability insurance ("OASDI"), which correlates to the Social Security program that provides monthly benefits after retirement, disability, or death; and (2) Medicare hospital insurance ("HI"). The OASDI tax rate is 6.2 percent on both the employee and employer (for a total rate of 12.4 percent). The OASDI tax rate applies to wages up to the OASDI wage base ($102,000 for 2008). The HI tax rate is 1.45 percent on both the employee and the employer (for a total rate of 2.9 percent). Unlike the OASDI tax, the HI tax is not limited to a specific amount of wages, but applies to all wages.

For purposes of the employer's and employee's share of FICA, wages generally means all remuneration for employment including the cash value of all remuneration paid in a medium other than cash. However, the general definition of wages is subject to a number of special rules and exceptions.[3]

Employment for FICA purposes generally means any service of whatever nature performed by an employee for the employer (irrespective of the citizenship or residence of either) within the United States. In the case of service outside the United States, employment also includes service performed by a United States citizen or resident as an employee for an American employer. As in the case of the definition of wages, the definition of employment is also subject to a number of exceptions and special rules.[4] An American employer is defined as an employer which is: (1) the United States or any instrumentality thereof; (2) an individual who is a resident of the United States; (3) a partnership, if at least two-thirds of the partners are

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[2] Secs. 3101-3128 (FICA). Sections 3501-3510 provide additional rules.

[3] Sec. 3121(a).

[4] Sec. 3121(b). For example, employment for FICA purposes includes certain service with respect to American vessels or aircrafts and also includes service that is designated as employment under an agreement entered into under section 233 of the Social Security Act.

United States residents; (4) a trust, if all of the trustees are United States residents; or (5) a corporation organized under the laws of the United States or any of the States.[5]

Section 3121(l) agreements

An American employer may enter into a voluntary agreement with the Secretary of the Treasury to extend coverage of the insurance system of Title II of the Social Security Act to service performed outside the United States in the case of certain employees. Specifically, such an agreement may be entered into with respect to employees of a foreign affiliate of the American employer who are United States citizens or residents.[6] Such an agreement is commonly referred to as a "section 3121(l) agreement", and is entered into by completing Internal Revenue Service Form 2032. A foreign affiliate for purposes of the section 3121(l) agreement is any foreign entity in which the American employer has at least a 10-percent interest.[7]

If a section 3121(l) agreement is entered into, the American employer agrees to pay the Secretary of the Treasury amounts equivalent to the employer and employee's share of FICA (including amounts equivalent to interest, additional taxes, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment for purposes of FICA. In addition, the American employer agrees to comply with such regulations relating to payments and reports as the Secretary of the Treasury may prescribe.[8] A section 3121(l) agreement may not be terminated with respect to a foreign affiliate after June 15, 1989.[9]

In the case of a domestic corporation, a deduction is allowed for amounts paid or incurred pursuant to a section 3121(l) agreement with respect to services performed by United States citizens employed by foreign subsidiary corporations.[10] Any reimbursement of any amount previously allowed as a deduction is included in gross income in the year received.

Totalization agreements

Under section 233 of the Social Security Act, the President of the United States is authorized to enter into agreements establishing totalization arrangements between the social security system of the United States and the social security system of a foreign country (referred

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[5] Sec. 3121(h).

[6] Sec. 3121(l).

[7] Sec. 3121(l)(6).

[8] Sec. 3121(l)(1).

[9] Sec. 3121(l)(3).

[10] Sec. 176.

to as a "totalization agreement").[11] The purposes of a totalization agreement are (1) to establish entitlement to and the amount of old-age, survivors, disability, or derivative benefits based on a combination of an individual's periods of coverage under the United States social security system and the social security system of a foreign country, and (2) to prevent imposition of employment taxes by two countries on the same wages.

For purposes of FICA, during any period in which a totalization agreement is in effect, wages paid to an individual are exempt from the employer's and employee's share of FICA to the extent such wages are subject under the agreement exclusively to the laws applicable to the foreign country's social security system.[12]

Description of Proposal

Under the proposal, a foreign person is treated as an American employer with respect to certain employees for purposes of determining whether their employment is subject to the employer's and employee's share of FICA. Specifically, a foreign person is treated as an American employer with respect to an employee of the foreign person who is performing services in connection with a contract between the United States government (or any instrumentality thereof) and any member of any domestically controlled group of entities which includes such foreign person. Thus, under the proposal, service performed as an employee for such an employer outside of the United States by a United States citizen or resident in connection with such a contract is employment that is subject to FICA. A domestically controlled group of entities is a controlled group of entities the common parent of which is a domestic corporation. For this purpose, a controlled group of entities is as defined in section 1563(a)(1) except that the ownership threshold is 50 percent rather than 80 percent and certain other changes are made, including that certain partnerships may be considered members of a controlled group. The sections 3101(c) and 3111(c) exceptions for wages not subject to FICA as a result of a totalization agreement applies under the proposal. Also, this proposal does not apply to any services covered by an agreement under section 3121(l).

The proposal provides that the common parent of the domestically controlled group of entities is jointly and severally liable for the FICA taxes for which the foreign person is liable as a result of the proposal. In addition, the common parent is liable for any penalty imposed on the foreign person with respect to any failure to pay the FICA taxes or any failure to file any return or statement with respect to such tax or wages subject to such tax. No deduction is allowed for any liability imposed on the common parent as a result of these joint and several liability rules.

Effective Date

The proposal is effective for services performed after the date of enactment of the proposal.

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[11] 42 U.S.C. sec. 433.

[12] Secs. 3101(c) and 3111(c).