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COMMITTEE PRINT

INCOME TAX OVERPAYMENTS  
BY THE ELDERLY

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A REPORT

BY THE

SPECIAL COMMITTEE ON AGING  
UNITED STATES SENATE



DECEMBER 1970

Printed for the use of the Special Committee on Aging

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## PREFACE

Congress has attempted within recent years to reduce long-standing inequities and outright injustices within the Federal income tax system.

The Tax Reform Act of 1969—providing as it does some relief for low- and moderate-income citizens—was a long step forward. It dealt effectively with major problems related to social and economic consequences of tax policy.

But new concepts of social and economic justice mean little to the taxpayer if he finds himself baffled when he attempts to comply with the tax law.

And the plain fact is many Americans cannot interpret Internal Revenue Service rulings and instructions into commonsense language. To them, the income tax form is a morass of tables, transfers, and linguistic booby traps. More and more, the individual taxpayer must rely on accountants or other specialists for help when April 15 nears; and even then they may find that the "experts" admit to some puzzlement, too, on especially perplexing matters.

Dissatisfaction with the income tax form and with the IRS seemed to reach new heights in 1970, causing some concern among several Congressional units.

The Senate Special Committee on Aging—alarmed by reports that large numbers of older Americans were victims of income tax overpayments—asked for the facts at a hearing last April 15.

On that symbolic date, the Committee heard from the IRS, from elderly individuals, representatives of national organizations, and from the director of the Nation's largest tax consulting service. It became crystal clear that millions of Americans of age 65 and beyond—couples, widowers and widows living on fixed income—are paying more than they should in income taxes each year. They are experiencing frustration, anxiety, and resentment made all the more intense by unique problems which come with age and with murky IRS regulations on such matters as the retirement income credit. For widows—many of whom never gave a moment's thought to an income tax form before the passing of their husbands—the problem is especially severe.

Reasons for the unique—and intensifying—problems for the elderly are provided on the following pages. Suggestions are made for change; *and change is not only possible, it is essential*. Tax inequity, intolerable for *any* American, is even more galling for those among us who have worked and saved for the better part of their lifetimes, only to find that retirement savings and incomes dwindle far more rapidly today than they could possibly anticipate.

The Internal Revenue Service has already taken positive steps to deal with several problems discussed at the hearing; and its director is to be commended for his receptivity. He will find, in this report, several other suggestions worthy of his close attention. In addition, members of the Congress will find that other recommendations will require legislative action for fulfillment.

Acknowledgment should be given at this point to the role played by Mr. Ira C. Funston in preparations for the hearing and in other, earlier activities related to income tax payments by the elderly. Mr. Funston, who retired from his position as Assistant Solicitor in the Department of Labor several years ago, is now a part-time professional staff member for this Committee. It was his suggestion which led to pilot tax assistance training programs for the elderly two years ago; and it was his personal experience which led to discussion of many major issues at the hearing. The Committee is also indebted to the late Othie Burk, former Vice President of the National Association of Retired Civil Employees.\* Mr. Burk, had given direct assistance over the years to many NARCE members in need of tax advice; and he gave generously of his time before and during the April 15 hearing. Another major contribution was made by the Counsel to this Committee, Mr. David Affeldt, who drew upon his own personal expertise in tax matters during the preparation of this report.

The Committee on Aging, in presenting recommendations meant to assure more equitable tax treatment for the elderly, may also perform a service for younger taxpayers, too. If the tax form can be simplified for the elderly, it can be simplified for others, too. If IRS requirements can be made more comprehensible for older Americans, so can they be for the breadwinner trying to send his youngsters through college. As always, every American has a stake in the way his government treats every other American.

—HARRISON A. WILLIAMS, Jr., *Chairman.*

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\*Mr. Othie G. Burk, deceased Oct. 1, 1970.

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## INCOME TAX OVERPAYMENTS BY THE ELDERLY

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DECEMBER —, 1970.—Ordered to be printed

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Mr. WILLIAMS, from the Special Committee on Aging,  
submitted the following

### REPORT

#### INTRODUCTION

“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.” *Gregory v. Helvering*, 293 U.S. 465, 469 (1935).

Time and time again the Internal Revenue Service has informed taxpayers that the Federal Government wants no individual to pay more taxes than are legally due.

Each taxpayer is entitled to all exemptions, deductions and credits as authorized by the Internal Revenue Code.

A number of publications—such as “Tax Benefits for Older Americans”<sup>1</sup>—have helped to provide valuable assistance for elderly taxpayers.

Yet millions of older Americans—as well as younger persons—probably overpay their taxes each year. Many make errors because of complexities in the tax law or intricacies in computing their returns. Others are simply unaware of certain legitimate deductions.

Alarmed by reports<sup>2</sup> that substantial numbers of retired persons were overpaying their taxes, the Senate Special Committee on Aging called a hearing on April 15, 1970, on “Income Tax Overpayments by the Elderly.”

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<sup>1</sup> “Tax Benefits for Older Americans” provides helpful information for elderly taxpayers on several provisions which can result in substantial tax savings for them—such as the retirement income credit, the medical expense deduction, and the partial or total exclusion of the gain from the sale of a personal residence.

<sup>2</sup> For example, the March 20, 1970 issue of the *New York Times* indicated that many retired persons receiving pensions or annuities “may now be overpaying their taxes because the law is so complicated they misunderstand it” (p. 32).

In his opening statement, Committee Chairman Harrison A. Williams said:

This is an intolerable situation and, if true, must be rectified at once. Since a substantial percentage of these individuals live on limited fixed incomes, they can ill afford to make these costly errors.<sup>3</sup>

Later, he added:

In 1969 we made a significant step toward a more equitable tax system with the enactment of the Tax Reform Act.<sup>4</sup> The next logical step, it seems to me, is to make it more readily understandable and workable.<sup>5</sup>

Several expert witnesses confirmed reports that large numbers of older persons pay more taxes than required by law. Mr. Henry W. Bloch—President of the nation's largest tax service, H. & R. Block, Inc.—said:

*Do our over-65 taxpayers overpay their income taxes? Of course they do.* Statistics relating to the extent of those overpayments are much better known to the Treasury, but there can be no doubt that our current laws and reporting forms, as they deal with tax reporting by our elderly citizens, have resulted in confusion, improper reporting, and a widespread failure to take advantage of the tax-reducing devices available.<sup>6</sup> (Emphasis added.)

Another tax expert, Mr. Othie Burk,<sup>7</sup> added:

I join him [Mr. C. Ira Funston] in estimating that at least 50 percent of our people overpay their taxes. . . .<sup>8</sup>

Others stressed the need for expanded tax assistance programs. Mr. C. Ira Funston<sup>9</sup>—organizer of Tax Assistance by the Elderly for the Elderly<sup>10</sup>—pointed to a number of cogent reasons which led him to establish his program on a demonstration basis.

—Many persons were completely unaware of the existence of the retirement income credit. In a discussion club for older persons—individuals presumably with greater access to information than the average taxpayer—less than half had ever heard of the 15 percent credit.

—Some persons did not even know that they were entitled to an additional personal exemption when they reached age 65.

—Many found certain tax relief measures, such as the deduction for medical and dental expenses, complicated and difficult to compute.

<sup>3</sup> Hearing on "Income Tax Overpayments by the Elderly," by the Senate Special Committee on Aging, Washington, D.C., April 15, 1970, p. 2.

<sup>4</sup> For a discussion of tax relief provisions in the Tax Reform Act, see app. 1, p. 17.

<sup>5</sup> P. 3, hearing cited in footnote 3.

<sup>6</sup> P. 45, hearing cited in footnote 3.

<sup>7</sup> Mr. Othie G. Burk (deceased, Oct. 1, 1970), former Vice President of the National Association of Retired Civil Employees.

<sup>8</sup> See p. 16, hearing cited in footnote 3.

<sup>9</sup> Mr. C. Ira Funston, former attorney with the U.S. Department of Labor and now a professional staff member for the Senate Special Committee on Aging.

<sup>10</sup> This program is discussed in greater detail at p. 9 of this report.

Moved by compelling testimony at the April hearing, the Committee has concluded that far-reaching action is needed now to help reduce the confusion and frustration experienced by elderly persons in preparing their returns for 1970.

For these reasons, the Committee has prepared this report to identify the various aspects of the income tax overpayments problem and to offer concrete recommendations for improvement.

The scope of this report is necessarily confined to the aged because the Committee on Aging's jurisdiction is limited to problems affecting the elderly. This report, however, will be important for all age groups, since many tax issues apply with equal force to the young as well as the old.



## PART 1

### WHO ARE THE ELDERLY TAXPAYERS? WHAT ARE THEIR PROBLEMS?

Many retirees never worry about income taxes simply because they are too poor to file returns.<sup>11</sup> Yet, a surprisingly large number—8.8 million—had a sufficient amount of taxable income in 1968 to file Federal income tax returns.

Older Americans, persons 65 and over, file about 9 percent of all tax returns.

According to the latest complete data available:

—Nearly 6.9 million returns (some were joint returns of married couples) were filed by elderly persons for taxable year 1968.

—Their total tax liability for that year amounted to \$7.6 billion, approximately \$1,100 for each return filed.

—3.3 million returns itemized their deductions. Nearly 2.5 million used the minimum standard deduction, and another 1 million took the 10-percent standard deduction.<sup>12</sup>

—Approximately 2.8 million returns had additional tax due at the time of filing, amounting to more than \$1.9 billion.

—Another 2.4 million returns were entitled to refunds, but the total amount (\$730 million) was less than one-half of the payments owed at the time of filing.

—About 2 million returns reported taxable pensions and annuities.

#### I. PROBLEMS RELATED TO "BEING OLD"

There is no doubt that elderly taxpayers have unique and intense tax problems which are more severe than for other age groups.

**Upon reaching age 65 a taxpayer is confronted with an entirely new set of tax rules, usually much more complicated than the ones he was accustomed to during his preretirement years.**

A few narrative examples may help to illustrate the dilemma facing the older taxpayer.

<sup>11</sup> In 1967, only half of all families with a head 65 and older received as much as \$3,928; nearly one in five had incomes below \$2,000. Of the older people living alone or with nonrelatives, half had incomes no larger than \$1,480; one in four had as little as \$1,000 or less.

The income distributions of those under and over age 65 vary markedly. Of the 7.1 million families with an aged head in 1967, almost 10 percent, or 700,000, had incomes under \$1,500, as compared with 3 percent of the younger families. Almost 37 percent of the older families had incomes of less than \$3,000; this was more than four times the proportion (8 percent) of younger families.

At the other end of the scale, 13.5 percent of the older families—about 950,000—had incomes of \$10,000 or more. Almost 38 percent of the younger families had incomes of \$10,000 and above.

Of the 5.1 million aged unrelated individuals—many of them widows—a quarter or 1.3 million had 1967 incomes of less than \$1,000 and another quarter had incomes between \$1,000 and \$1,500. Only one quarter of the younger individuals—relatively half as many—had incomes below \$1,500. Less than a tenth of the older individuals, but more than a third of the younger, had incomes of \$5,000 or more in 1967.

<sup>12</sup> Itemized deductions include medical and dental expenses, taxes, charitable contributions, interest and allowable miscellaneous items (e.g. alimony).

As a general rule, the minimum standard deduction is \$200 plus \$100 for each exemption claimed, but not in excess of \$1,000. In the case of a married couple filing separately, the deduction is \$100 plus \$100 for each exemption claimed, but not in excess of \$500 for each taxpayer.

The standard deduction is 10 percent of an individual's adjusted gross income with a \$1,000 ceiling.

*Pension: Blessing or Anathema.*—John, a moderate-income wage earner, retires after 40 years of work. During his preretirement years, he prepared his own return. He encountered little difficulty then because his income was not complicated (just wages and interest), and he elected to use the standard deduction.

Now John will receive a pension from his company for the rest of his life. And he is faced with numerous complicated computations beyond his comprehension.<sup>13</sup> He must determine his “expected return”, based on his life expectancy according to the annuity tables. In addition, he must determine the taxable portion of his annuity.

Finally John gives up in frustration and seeks professional help. His return is prepared accurately, but it costs him \$60.

*Taxing the Wisdom of Solomon.*—Bob is forced to retire at age 65 because of failing health. Doctor bills and prescription drug costs continue to deplete his meager financial resources. A few years later his property taxes are increased substantially. Finally he decides to sell his home and move into an apartment in Florida.

But when Bob tries to fill out Form 2119 (Statement Concerning Sale or Exchange of Personal Residence),<sup>14</sup> he is completely befuddled. He can't figure out the difference between the “sales price” and the “adjusted sales price”. Now he must also seek outside help, even though he will have difficulty paying for it.

*Fine Print.*—Jim was formerly a successful insurance executive who also made numerous investments. In his business and investment dealings, he acquired a great deal of helpful information on tax planning and tax preparation. Since Jim was “tax oriented”, he had little trouble computing his capital gains, rental income, dividends and oil depletion allowance.

But now Jim is 75 years old. His eyesight is failing, and he experiences great difficulty in reading the fine print on the form. Jim is still alert, but his vision is too poor to prepare his own return.

***The Widow.*—Perhaps the most troubled individual is the elderly widow, who typically has low or moderate income and little experience in tax matters. As a general rule, the husband usually prepares his family's return or he contacts a tax consultant to do the job. As a result, most elderly widows are ill prepared to complete their own tax form.**

In noting the gravity of the situation for women, Mr. Funston informed the Committee:

Widows are the ones who are really in the most trouble in these forms. They have had no experience with it and I will tell you, I think this is the period when most women really mourn for the loss of their husbands during this particular period because they really are in a pickle and I think more women come to us than men.<sup>15</sup>

**In addition, there are other perplexing tax problems associated with advancing age.**

**—Many older Americans do not seek professional advice because they cannot afford it.**

<sup>13</sup> For a more detailed discussion concerning the computation of the taxable portion of an annuity, see app. 2, “Troublesome Provisions in the Internal Revenue Code for Elderly Taxpayers,” p. 23.

<sup>14</sup> For a more detailed discussion concerning the tax computations for the sale of a residence, see app. 2, p. 21.

<sup>15</sup> See p. 15, hearing cited in footnote 3.

- Assistance provided at IRS offices, although very helpful, is not generally utilized by older persons because of large crowds and long waiting periods under burdensome conditions.
- Many senior citizens are unable to receive help at tax assistance centers because of failing health or inadequate transportation facilities.

## II. PROBLEMS RELATED TO COMPLEX STATUTORY PROVISIONS<sup>16</sup>

Anyone who prepares a tax return, regardless of his age or intelligence, is likely to encounter a certain amount of difficulty.

Undoubtedly one major reason is because of the intricacies and nuances written into the tax law. Unfortunately the goal of a more equitable tax system does not always coincide with the objective of simplifying the Internal Revenue Code.

In drafting legislation to achieve greater equity in our tax system, all of the varying circumstances must be considered in proper perspective. Frequently these considerations are complicated and lead to greater complexities in our tax structure.

A moderately simple example can illustrate the intricacies of tax rules for different situations. For instance, travel for personal purposes is a nondeductible expenditure. But in connection with a taxpayer's business, it is an authorized deduction. When a taxpayer drives from his home to work in the morning, his travel expenses are considered personal commuting expenditures. Consequently, these items may not be deducted on his tax return. However, if the same taxpayer "moonlights", he may now properly deduct 12 cents a mile for traveling from his primary post of employment to his secondary job.

## III. PROBLEMS RELATED TO THE INCOME TAX FORM

Several provisions in the Internal Revenue Code are intended to provide tax relief for older Americans. However, these measures are of little benefit if the tax form camouflages them or confuses the taxpayer beyond comprehension.

Most assuredly, the complexity of the statutory language accounts for much difficulty and misunderstanding. But, the form itself, also contributes significantly to the taxpayer's confusion.

In many instances there is a virtual labyrinth of calculations, procedures and schedule transfers to complete Form 1040. Perhaps the most striking example is the retirement income credit. It requires an entire separate schedule—with accompanying instructions on the back page—to complete. As a consequence, many elderly taxpayers do not take full advantage of their legitimate tax benefits.

This year the preparation of the return was possibly a more agonizing experience for several million individuals because of the so-called "simplified" Form 1040. Previously individual taxpayers had an option for filing two tax forms: (1) Form 1040 and (2) the Punch Card Form 1040A.

<sup>16</sup> These provisions are discussed in greater detail in app. 2, p. 20.

Form 1040 was required for persons electing to itemize their deductions, but could also be used by taxpayers claiming the standard deduction or the minimum standard deduction.<sup>17</sup>

Form 1040A was designed for taxpayers with smaller amounts of income, consisting almost entirely of wages subject to Federal withholding. If his income was less than \$5,000, the taxpayer could also elect to have the Internal Revenue Service compute his tax for him.

For the 1969 taxes, the old Form 1040 and 1040A were combined into one new form, also called Form 1040. In discussing the reasons for abolishing the short form, Commissioner Randolph Thrower said:

. . . a significant number of users of the short form were overpaying their taxes because the short form did not allow many tax benefits such as itemized deductions, retirement income credit, sick pay exclusion, head of household status, surviving spouse status, and so forth.<sup>18</sup>

In the judgment of many tax authorities, the new form caused additional confusion for the unsuspecting taxpayer.

Zachary Scheer, a member of the accounting firm of J. K. Lasser Co., remarked:

The new form was designed to work nicely in the government's computers. It did the job, but the designers forgot about the individual taxpayers.<sup>19</sup>

In fact, the new form caused such a furor that there was some speculation concerning another potential "taxpayers' revolt" among all age groups.<sup>20</sup>

<sup>17</sup> See footnote 12 for a more detailed description of itemized deductions, the minimum standard deduction and the standard deduction.

<sup>18</sup> See p. 23, hearing cited in footnote 3.

<sup>19</sup> Business Week, April 11, 1970, p. 27.

<sup>20</sup> On January 17, 1969, former Secretary of the Treasury Joseph W. Barr warned the Joint Economic Committee of a possible "taxpayers' revolt" unless existing tax loopholes would be closed. In his statement he said:

"The middle classes are likely to revolt against income taxes not because of the level or amount of the taxes they must pay but because certain provisions of the tax laws unfairly lighten the burdens of others who can afford to pay."

"People are concerned and indeed angered about the high-income recipients who pay little or no Federal income taxes."

Another possible "taxpayers' revolt" was discussed in 1970. This possibility was raised because of the complexities in the new "simplified" form 1040.

A Washington Post editorial (April 11, 1970), entitled "Income Tax Blues," began by saying:

"If there is no mass demonstration against the Internal Revenue Service as income tax day approaches this week, it will be only because long-suffering taxpayers all over the land are too exhausted to mount one. Filling out form 1040 has been the worst ordeal in years. Especially those taxpayers who were accustomed to filling out the short 1040A punch card form in previous years must have climbed up the wall and across the ceiling over the complexities inflicted upon them this year."

Senator Frank Moss also noted at the hearing on "Income Tax Overpayments by the Elderly":

"There is no indication that the danger of a 'taxpayer's revolt' has lessened and it is about time that something positive be done about it."

## PART 2

### RECOMMENDATIONS FOR ACTION

Substantial and far-reaching changes were made in the Federal tax system in December 1969 with the enactment of the Tax Reform Act.

Since many of the new provisions are complicated, the frustrations of the forthcoming tax season may be mild in comparison to what will be in store for the unsuspecting taxpayer next year.

Yet much can be done to improve the tax form and to make tax assistance available for older Americans in great need.

This report offers a number of recommendations to protect the elderly from overpaying their taxes and to help simplify tax preparation. Implementation of these recommendations can also be an important step forward in making our tax system more readily workable and understandable for older and younger taxpayers.

#### I. EXTENSION OF TAX ASSISTANCE PROGRAMS FOR THE ELDERLY

At the urging of the Senate Committee on Aging, a tax assistance program for elderly persons was established in 1968 with the cooperation of the Internal Revenue Service. C. Ira Funston, professional staff member for the committee, joined three other older individuals in setting up a program in Washington, D.C. Elderly persons were recruited and trained by the IRS to assist other senior citizens in preparing their returns.

A number of preliminary findings have forcefully demonstrated the value of the program both for the older participants and the elderly served. Moreover, there is strong evidence that older Americans are possibly better equipped to assist elderly taxpayers because they have first hand familiarity with many of their problems.

C. Ira Funston, organizer of the program, informed the Committee:

The difficult problem of obtaining volunteers was made relatively easy by making it a project staffed by older persons.

There is a great reservoir of experience and talent among retirees. They not only have ability but time. They not only have time but the desire to use it in good causes.

They understand the problems of older people and are able to obtain their confidence.

The experiment has worked well. It has been a boon not only to those who get help but to those who give it.<sup>21</sup>

During the first year of operation, 75 individuals were assisted. Since then the program has been expanded to other cities. Based on interim information received from the IRS, training was made available in at least 60 cities in all sections of the Nation.

<sup>21</sup> Memorandum from C. Ira Funston to Senate Committee on Aging.

Examples of valuable assistance provided older Americans are many. For instance, 24 representatives trained by the San Francisco IRS office assisted approximately 485 elderly taxpayers in 1970.

Some of the items in which volunteers help include—

- The retirement income credit,
- Taxability of annuities,
- Deduction for medical expenses, and
- Other applicable provisions for older persons.

Randolph Thrower, Commissioner of the IRS, noted:

It is our opinion that training in these and other items should prove of substantial help to the elderly in preparing complete and accurate returns. Informal comments from representatives of the National Association of Retired Civil Employees substantiates this opinion.<sup>22</sup>

**Because of the complexities of the provisions in the income tax law, many older persons need assistance in preparing their returns. For those persons with limited incomes, assistance should be made more readily available and without charge.**

**Two years of successful operations of the pilot project—Tax Assistance by the Elderly for the Elderly—have amply demonstrated the need for such assistance and the effectiveness of older persons in helping other elderly taxpayers. Efforts should be made at once to expand this program substantially and to provide funds for a truly national program.**

**In addition, the IRS should assign specific personnel during the tax season to furnish guidance and assistance to elderly volunteers to keep them abreast of developments in the tax law.**

## II. PAYMENT OF CERTAIN EXPENSES FOR VOLUNTEERS

Transportation, meals and other expenses in performing tax assistance services can be major expenditures for elderly persons, especially for those living on fixed incomes. Many other “would-be” volunteers are precluded from rendering this assistance because their budgets cannot withstand these additional outside expenses.

**To encourage more elderly participants in tax assistance programs, it is recommended that volunteers be reimbursed for transportation, meals and other out-of-pocket expenses incident to such services.<sup>23</sup>**

## III. TAX ASSISTANCE FOR HOMEBOUND

Millions of elderly persons today find themselves homebound because of failing health or lack of adequate transportation facilities. An additional 1 million also live in nursing homes and related care facilities—nearly 5 percent of all older Americans.

<sup>22</sup> See p. 44, hearing cited in footnote 3.

<sup>23</sup> A new Retired Senior Volunteer Program (“RSVP”)—established under the 1969 Amendments to the Older Americans Act—would be ideally suited for such an undertaking, if proper funding were available.

RSVP provides new opportunities for persons 60 and older to serve in their communities. These community volunteers would receive no pay except reimbursement for transportation, meals and other expenses incident to the performance of their services.

Although \$10 million is authorized in fiscal 1971 for RSVP, no appropriations have been requested by the Administration. On June 16, 1970, Senator Harrison Williams appeared before the Senate Labor-HEW Appropriations Subcommittee and urged \$5 million in funding for RSVP. In addition, he noted that this funding could be helpful in “assisting elderly taxpayers in preparing their tax returns.”

Yet, a significant percentage of these "immobile" persons have a sufficient amount of income to require the filing of a tax return. Moreover, they may be in the greatest need for assistance since physical infirmities, such as failing eyesight, may make it difficult or impossible for them to prepare their own return.

**Outreach efforts are needed now for older persons who are unable to travel to tax assistance centers. Funding should be made available to expand existing tax service programs by the elderly to close this gap in coverage. Reimbursement for travel expenses would also enable older tax preparers to assist other senior citizens in great need. In addition, efforts should be made to enlist individuals from nursing home associations to provide these services for their patients.**

#### IV. A SENIOR 1040 FORM?

For many older Americans, a complex form has the effect of imposing a second surtax—this one paid to tax accountants and others who must be called in to prepare the form.<sup>24</sup>

In 1970 it is estimated that about 50 percent of all taxpayers sought outside help in preparing their returns.

However, the preparation of a tax return should be made simpler for the average older person, since his reduced income limits his ability to pay a professional for the advice and assistance he needs.

A number of measures in the Tax Reform Act—such as the new low-income allowance and the increase in the standard deduction—will also help simplify tax preparation for the elderly, since many will no longer have to itemize their deductions.

In addition, a suggestion has been made for adoption of a "Senior 1040" designed for use only by taxpayers with incomes under a certain level which would omit sections of the current forms which are causing the most problems to the elderly.<sup>25</sup>

**It is recommended that the Internal Revenue Service undertake a study for establishing a "senior short form" for low- and moderate-income elderly taxpayers who do not itemize their deductions. It is also recommended that the Internal Revenue Service file a report with the Committee on Aging concerning:**

- The feasibility of designing such a form, and
- Other alternatives which may simplify the tax form for senior citizens.

#### V. SIMPLIFYING THE RETIREMENT INCOME CREDIT SCHEDULE

The retirement income credit was adopted in 1954 to provide government pensioners (such as retired teachers, policemen, firemen, and Federal annuitants) with comparable tax treatment as Social Security beneficiaries. Social Security benefits are, of course, exempt from Federal income tax. Government annuitants receive substantially equivalent tax relief by claiming a 15 percent credit on their taxable retirement income—pensions, annuities, rents, interest and dividends.

<sup>24</sup> A taxpayer is, of course, allowed a deduction for fees paid to professional consultants for the preparation of his return. In terms of tax savings, his benefit is only worth the amount of the deduction times his tax rate. For example, if a taxpayer in the 20 percent tax bracket spent \$10 to have his return prepared, his tax benefit would only be \$2 (i.e., \$10 which is the amount of his deduction multiplied by 20 percent—his tax rate).

<sup>25</sup> See p. 47, hearing cited in footnote 3.

It is estimated that about one-third of those eligible for the credit may not be claiming it because of its complexity and numerous schedule transfers.

A recent study of Federal retirees revealed that 75 percent reported their annuities inaccurately. It is also quite apparent that most of them were not attempting to cheat the Government since two-thirds of those reporting incorrectly overpaid their taxes.

The retirement income credit section <sup>26</sup> in the Internal Revenue Code is undoubtedly a complicated provision, but a number of steps could be taken to simplify Schedule R.

**The committee strongly recommends the establishment of a simplified retirement income credit schedule which will eliminate unnecessary tabulations and schedule transfers. Specifically the committee urges that the reference to "credits for foreign taxes and tax free covenant bonds" be removed from the basic computation of Schedule R, since this line reference causes great confusion and misunderstanding for many taxpayers. For the relatively small percentage of elderly taxpayers claiming credits for foreign taxes and tax free covenant bonds, a separate "Part II" should be established to take into account this computation.**

(Following the hearing on "Income Tax Overpayments by the Elderly", the IRS met with representatives from the Senate Committee on Aging and Senior Citizen Organizations to consider a number of proposals to improve the tax form. Several suggestions were offered to simplify the retirement income credit schedule, to improve schedule A, and to make other recommendations. One change was to simplify the retirement income credit schedule. Next year's retirement income credit schedule will be divided into two parts. Part I will be designed for persons with "typical" retirement income credit computations, and will be substantially shorter than this year's schedule. A new Part II will also be established for persons claiming credits for foreign taxes or tax free covenant bonds.)

**Additionally, the committee urges that taxpayers be notified on Schedule R that they may elect to have their retirement income credit figured by the Internal Revenue Service.**

(Taxpayers filling out returns in 1971 may choose to have the Internal Revenue Service compute their retirement income credit. Persons so electing will only have to list: (1) the amount of their tax exempt pensions (e.g., Social Security and Railroad Retirement) and earned income and (2) their total qualifying retirement income—their taxable pensions, annuities, interest, dividends, and rents.)

## VI. LINE REFERENCES FOR DEDUCTIONS

Taxpayers electing to itemize their deductions are required to complete a separate Schedule A. This schedule serves as a work sheet for tabulating their allowable deductions—medical and dental expenses, taxes, charitable contributions, interest, and miscellaneous items (e.g., alimony and fees paid to tax preparers).

However, many common allowable deductions are still not listed on Schedule A. Under medical and dental expenses, for instance, there is

<sup>26</sup> Section 37 of the Internal Revenue Code, 26 U.S.C. 37.



no designated line for travel expenditures for medical purposes. Other important items are also omitted.

There are 26 blank lines alone for itemized medical and dental expenses on Schedule A. It would be relatively easy to list some of the more common expenditures—such as travel expenses, eyeglasses, hearing aids, or dentures.

**Therefore, it is recommended that more common itemized deductions should be listed as line items on Schedule A—wherever possible—in order to help assure that taxpayers will take advantage of all allowable deductions.**

(Next year's form will incorporate part of the Committee's recommendation. For instance, Schedule A will have additional specific line references for medical and dental expenditures—including travel expenses, eyeglasses, and hearing aids.)

#### VII. INSTRUCTIONS ON THE BACK OF THE FORM

Another major problem of this year's form is that the instructions are on the back of the return.

Senator Frank Moss aptly pointed out the dilemma posed by this practice:

A person who has filled out his form and sent it off, and then starts to think about it again, has no instructions to refer back to. They've been sent off with the form.<sup>27</sup>

When questioned by Senator Williams on this issue, Commissioner Thrower stated:

I think this is a mistake, which is one of those which we will take into account next year.<sup>28</sup>

**Many taxpayers discover errors after filing their returns. Others wish to reread the instructions to make absolutely certain that they have claimed all legitimate deductions and credits. Therefore, the committee strongly urges that:**

- A separate packet of instructions be sent with next year's income tax form, and
- No instructions be printed on the back of the return.

(These recommendations were agreed to by the IRS at the hearing on "Income Tax Overpayments by the Elderly", and subsequently implemented.)

#### VIII. COMPUTATION OF TAXABLE ANNUITIES

Many older persons are unable to compute the taxable portion of their annuities or pensions because of the complexities involved.<sup>29</sup> Even renowned experts experience difficulty with the more complicated computations. For example, Mr. Edwin Cohen, Assistant

<sup>27</sup> See p. 27, magazine cited in footnote 19.

<sup>28</sup> See p. 40, hearing cited in footnote 3.

<sup>29</sup> For a more detailed discussion of the steps in computing the taxable portion of an annuity, see app. 2, p. 23.

Secretary for Tax Policy for the Department of the Treasury, told a group of tax experts in New York on March 18, 1970:

With all the experts gathered here this evening, I doubt that a quarter of them could readily calculate the taxable portion of the pension received by a widow of an employee under a contributory pension plan—and I will include myself among them.<sup>30</sup>

Even under relatively less complicated circumstances, payers of annuities do not ordinarily inform elderly annuitants as to the taxable portion of their retirement income. A recent study by the IRS revealed that out of 25 pension and annuity plans studied—representing about 20 percent of all annuities paid in the United States—only 3 payers furnished this information to their annuitants.

Presently the Federal Government furnishes annual statements to annuitants, showing the gross amount paid each year. The next step will be to compute the taxable portion of pensions, which is scheduled to begin in 1971.

**Computing the taxable income from a pension oftentimes requires the use of material—such as an annuity life expectancy table—not readily available to the average retired worker. To help simplify this process, it is recommended that the IRS give technical assistance to private pension plans to assist retirees by computing the taxable portion of their annuities.**

<sup>30</sup> See pp. 60-61, hearing cited in footnote 3.

## PART 3

### COMMON DEDUCTIONS FREQUENTLY OVERLOOKED BY TAXPAYERS

Millions of taxpayers pay more taxes than legally required because they do not know about the existence of certain deductions.

Part three is designed to point out a number of common deductions frequently overlooked—deductions which can save elderly and younger taxpayers hundreds of dollars.

The following checklist is not exhaustive. But, it can be particularly helpful as a reminder of possible tax savings for individuals who itemize their deductions or are uncertain if it would be more advantageous to take the standard deduction or itemize.

Moreover, the failure to claim these deductions can still be rectified. A taxpayer may prepare a Form 1040X—Amended U.S. Individual Income Tax Return—to claim deductions not included on his original return. To claim a refund for these items, Form 1040X must be filed within three years after the original return was due or within two years from the time the tax was paid, whichever is later.

For example, an elderly taxpayer files his return in 1969 and itemizes his deductions. A year later he learns that travel expenses for medical purposes are properly deductible. In addition, he realizes that he did not deduct the fair market value of the clothing donated to his church, expenses for his dentures, and the cost of the safe-deposit box for his stocks and bonds. In 1970 he files Form 1040X and claims these legitimate deductions. A few weeks later he receives a refund for \$75 plus interest.

#### COMMON DEDUCTIONS OVERLOOKED (NOT SPECIFICALLY LISTED ON SCHEDULE A)

##### *Medical and Dental Expenses:*

Arches	Sacroiliac belt
Braces	Seeing eye dog and its maintenance
Chiropractor	Vaccines
Crutches	Supplementary Medical Insurance (Part B) under Medicare
Batteries for hearing aids	Vitamins prescribed by a doctor but not taken as a food supplement or to preserve general health
Insulin treatment	Wheelchairs
Orthopedic shoes	Whirlpool baths for medical purposes
Podiatrist	Ambulance expenses
Oculist	Physical examinations
Optician	
Optometrist	
Dermatologist	
Physiotherapist	
Psychiatrist	
Psychologist	
Psychoanalyst	
Psychotherapy	

*Taxes:*

Additional sales tax deduction for the purchase of large items, such as an automobile

Additional sales tax deduction (besides the table based on adjusted gross income of a taxpayer) for nontaxable income (e.g., Social Security or Railroad Retirement Annuities)

State transfer taxes on the sale of income producing property (e.g., securities)

*Charitable Contributions:*

Travel expenses (actual or 6¢ per mile) for charitable purposes  
Cost and upkeep of uniforms used in charitable activities (e.g., Scoutmaster)

Purchase of goods or tickets from charitable organizations (excess of amount paid over the fair market value of the goods or services)

Out-of-pocket expenses (e.g., postage, stationery, phone calls, donated foods) while rendering services for charitable organizations

*Interest:*

Penalty for prepayment of a mortgage is deductible as interest

*Miscellaneous Deductions:*

Rental cost of a safe-deposit box for income producing property

Fees paid to investment counselors

Subscriptions to business publications

Telephone and postage in connection with investments

Uniforms required for employment and not generally wearable off the job

Maintenance of uniforms required for employment

Special safety apparel (e.g., steel toe safety shoes, helmets worn by construction workers, special masks worn by welders)

Business entertainment expenses

Business gift expenses not exceeding \$25 per recipient

Employment agency fees for finding employment

Cost of a periodic examination if required by employer

Cost of installation and maintenance of a telephone required by the taxpayer's employment (deduction based on business use)

Cost of a bond if required for employment

Premiums for malpractice insurance for professional employees

Expenses of an office in your home if your employment requires it

Amounts a teacher pays to a substitute to take his place

Educational expenses required by your employer to maintain your position or for maintaining or sharpening your skills for your work

## APPENDIX 1

### HOW THE TAX REFORM ACT OF 1969 CAN HELP OLDER AMERICANS

One of the most significant laws passed during the 91st Congress was the far-reaching Tax Reform Act of 1969. Several provisions, such as the increase in the personal exemption and the new low-income allowance, in the new law will also provide substantial tax relief for older Americans. Other measures, such as the increase in the standard deduction, can help to make tax preparation easier—especially for moderate-income individuals.

These proposals can produce important tax savings—in some cases amounting to several hundred dollars—for older taxpayers. Consequently, a basic understanding of these relief measures will be essential for aged persons to receive full benefits from these provisions. Some of the major relief sections include:

*Increase in personal exemption deduction:* The Act provides for a four step increase in the personal exemption deduction from \$600 to \$750 by 1973. The four stages would be as follows:

- \$625 in 1970,
- \$650 for 1971,
- \$700 by 1972, and
- finally \$750 by 1973.

Older Americans will benefit doubly from this increased deduction. Under prior law, a person who was at least 65 years old was entitled to the regular exemption of \$600 plus an additional \$600 deduction for age—for a total of \$1,200. When this provision becomes fully effective, an elderly single taxpayer would be entitled to a \$1,500 personal exemption deduction—\$300 more than under previous law. By 1973, an elderly married couple would be entitled to an additional \$600 deduction for personal exemptions.

*Increase in standard deduction:* A three stage increase in the standard deduction will provide significant relief for moderate-income elderly taxpayers. The present standard deduction—10 percent of adjusted gross income with a \$1,000 ceiling—will be increased to 15 percent with a \$2,000 maximum by 1973. Under the new law, the percentages and maximum deductions will reflect the following changes:

Year	Percentage of adjusted gross income (percent)	Ceiling
1971.....	13	\$1, 500
1972.....	14	2, 000
1973.....	15	2, 000

*Low-income allowance.*—Older Americans will also benefit substantially from the new low-income allowance—equivalent to the former minimum standard deduction plus an additional allowance which would equal a maximum amount of \$1,100. More than 5 million tax returns will be removed from the tax rolls because of this provision.

The maximum \$1,100 low-income allowance becomes operative in 1970, but it will be reduced in two steps to \$1,000 by 1972 to correspond to the \$100 increase in the personal exemption deduction for 1972. This new low-income allowance together with the personal exemption deduction would be almost equivalent to the poverty index, and would have the effect of removing virtually all persons in the poverty category from the tax rolls.

The effect of the \$1,100 low-income allowance and the \$625 personal exemption is to eliminate tax until income exceeds the following levels for elderly persons in 1970:

Number of persons	Nontaxable Amount		
	Tax Reform Act	Prior Law	Difference
1. Elderly single person (65 or older)---	\$2, 350	\$1, 600	\$750
2. Elderly married couple (both 65 or older)-----	3, 600	3, 000	600

*Revision in tax rates for single individuals.*—The new revised tax structure for single persons who do not support a household in which a dependent lives will benefit many elderly widows and widowers. (Approximately 3.6 million elderly women are widows and live alone.)

Under previous law, the tax rate for a single individual was substantially higher than for a married couple filing a joint return with the same taxable income. In some instances a single taxpayer would pay 41 percent more in taxes than a married couple filing jointly. The new rate structure in the Tax Reform Act will help to relieve this inequity by providing a tax for single persons which will not be more than 20 percent of the tax paid on a joint return with comparable taxable income.

*No withholding under Certain Circumstances.*—Employees who certify to their employers that they had no tax liability for the preceding year and expect to have no tax liability for the current year will not have Federal income tax withheld from their wages.

About a half million persons 65 and over who work, are not subject to tax because of low taxable income. Previously, many elderly persons who owed no tax, still had to file returns to collect refunds because of the tax withheld.

Because of this provision and changes in filing requirements, more than 2 million older Americans will be relieved from the necessity of filing a tax return.

*Reduction and Repeal of the Surtax:* The 10 percent surcharge was reduced from 10 percent to 5 percent for the period from January 1, 1970 to June 30, 1970. Effective July 1, 1970, the surcharge will be discontinued. For an individual taxpayer, the effect will be to reduce

the surtax to 2.5 percent on an annual basis for 1970 and to eliminate the surcharge for 1971.

*Liberalized income averaging.*—Income averaging is available for individuals whose incomes fluctuate from year to year to help lessen the tax burden in high income years. Generally, a person is eligible for income averaging if taxable income for the current year is more than \$3,000 greater than 133½ percent of his average taxable income for the preceding four years.

The Tax Reform Act will lower the 133½ percent requirement to 120 percent. In addition, long-term capital gains, wagering income, and substantial income from gifts—which previously did not qualify—would be eligible for averaging.

*Tax savings under the Tax Reform Act.*—In 1969 it is estimated that persons 65 and older had an income tax liability of \$7.3 billion, exclusive of the surcharge. When fully effective, the relief provisions of the Tax Reform Act will reduce this liability by \$640 million (at 1969 levels)—a reduction of about 9 percent. Assistant Secretary Edwin Cohen estimated that “The tax liability of those persons with adjusted gross incomes below \$10,000 will be reduced by more than 25 percent, and that of persons with adjusted gross incomes below \$5,000 will be reduced by more than 54 percent.”<sup>31</sup>

When the Act is fully effective, an elderly married couple will pay no Federal income tax until their joint income (exclusive of Social Security and other nontaxable income) exceeds \$4,000—a \$1,000 increase over the 1969 tax-free level of \$3,000. Similarly, an elderly single individual will be able to have taxable income of \$2,500 without owing any tax—\$900 more than under previous law.

<sup>31</sup> See p. 28, hearing cited in footnote 3.

## APPENDIX 2

### TROUBLESOME PROVISIONS IN THE INTERNAL REVENUE CODE FOR ELDERLY TAXPAYERS <sup>32</sup>

A number of proposals have been incorporated in the tax law to provide relief for overburdened elderly taxpayers—such as the 15 percent retirement income credit, the exclusion from income of all or part of a gain from the sale of a personal residence, the exclusion from income of an individual's investment in an annuity or pension, and the medical expense deduction.

These measures can result in significant tax savings for persons living on limited fixed incomes. Yet, many individuals fail to take advantage of these legal tax benefits because of the complexities in computing the deductions, credits or exclusions.

A description of some of the major relief provisions has been prepared to illustrate the problems an elderly person would encounter in preparing his tax return.

*Retirement income credit.*—Five types of income—pensions, annuities, rents, interest, and dividends—qualify for this 15 percent credit.

For a single person, the credit is 15 percent of the lesser of:

- (1) His qualifying retirement income, or
- (2) \$1,524 (\$2,286 for a joint return where both taxpayers are 65 or over) minus the total of nontaxable Social Security benefits and Railroad Retirement annuities and earned income (depending upon the taxpayer's age and the amount of any earnings he may have).

For example, if the taxpayer is under 62, he must reduce the \$1,524 figure by the amount of earned income in excess of \$900. For persons at least 62 years old but less than 72, this amount is reduced by one-half of the earned income in excess of \$1,200 to \$1,700, plus the total amount over \$1,700. Persons 72 and over are not subject to the earned income limitation.

*Example:* John is 67 years old and has the following income for 1970.

Dividends (after \$100 exclusion).....	\$240
Railroad retirement pension (nontaxable).....	500
Disability benefits under Workmen's Compensation Act (nontaxable)...	400
Rental income (gross rents).....	900
Purchased annuity (\$600 minus return of investment of \$140).....	460
Earned income from a part-time job.....	2,000

<sup>32</sup> See Part 2 for additional discussion.



John would compute the credit as follows:

Retirement income includes:	
Dividends.....	\$240
Rental income.....	900
Purchased annuity.....	460
<b>Total retirement income.....</b>	<b>\$1,600</b>
But the retirement income is limited to.....	\$1,524
Less:	
Railroad retirement pension.....	\$500
50% of \$500 (earned income over \$1,200 but not over \$1,700)	250
Earned income over \$1,700 (\$2,000 less \$1,700).....	300
	1,050
Retirement income upon which credit is based.....	\$474

His retirement income credit is \$71.10 (15% of \$474).

*Medical expense deduction.*—Computation of the medical expense deduction on Schedule A (Itemized Deductions) is very complicated for many older Americans. First, the taxpayer is entitled to deduct one-half of his hospital or medical insurance premiums, up to \$150, without regard to the one percent (of adjusted gross income) rule for drugs and medicines or the three percent rule for medical and dental expenses. Then he determines the net amount he spent for drugs and medicines and subtracts one percent of his adjusted gross income from this amount. Any excess is carried forward with his excess medical insurance premiums to be added to his medical and dental expenses. From this total, the taxpayer subtracts three percent of his adjusted gross income. This net amount, if any, is added to the deduction for one-half of his medical insurance premiums, but not in excess of \$150.

*Example.*—Tom's doctor and hospital bills amounted to \$684, and medicines and drugs cost him an additional \$116—a total of \$800 for the year. He also paid \$200 during the year for medical insurance. He was reimbursed, from group hospitalization insurance: \$285 for doctors and hospital bills and \$25 for medicines and drugs. His Adjusted Gross Income was \$8,400. Tom's deduction is computed as follows:

One-half of medical insurance premium.....	\$100
Total cost of medicines and drugs (\$116—\$25 reimbursement).....	\$91
Less: 1% of \$8,400.....	84
Balance considered as medical expenses.....	\$7
Other medical expenses (including balance of insurance premiums: \$684 — \$285 reimbursement + \$100 for excess medical insurance premiums).....	499
Total medical expenses.....	\$506
Less: 3% of \$8,400.....	252
Total medical expense deduction.....	\$354

*Sale of personal residence by elderly taxpayers.*—A taxpayer may elect to exclude from gross income part, or, under certain circumstances, all of the gain from the sale of his personal residence provided:

- (1) He was 65 or older before the date of the sale, and

(2) He owned and occupied the property as his personal residence for a period totaling at least five years within the eight-year period ending on the date of the sale.

Taxpayers meeting these two requirements may elect to exclude their entire gain if the adjusted sales price (see definition below) of their residence is \$20,000 or less. If the adjusted sales price exceeds \$20,000, an election may be made to exclude part of the gain based on a ratio of \$20,000 over the adjusted sales price of the residence.

To begin this computation, the taxpayer subtracts his selling expenses (e.g. commissions in connection with the sale, advertising expenses, or legal fees) from the selling price of the residence. This gives him the amount realized from the sale. From this amount, he subtracts his adjusted basis in the residence (i.e. his cost plus any capital improvements made and minus any casualty loss or depreciation deductions allowed). This computation produces the total gain realized.

Then the taxpayer must determine his adjusted sales price—the amount realized minus any fix-up expenses. To qualify as fix-up expenses, they must:

- (1) be for work performed during the 90-day period ending on the day the contract to sell was made,
- (2) be paid within 30 days after the date of the sale,
- (3) be otherwise nondeductible in computing taxable income, and
- (4) not be capital expenditures or improvements.

If the adjusted sales price exceeds \$20,000, the gain which may be excluded from gross income is determined by multiplying the total gain realized by \$20,000 over the adjusted sales price. This amount is then subtracted from the total gain realized and produces the amount which the taxpayer may not elect to exclude from gross income.

*Example.*—Mr. James sold his principal residence for \$27,000 when he was 67. He is eligible to and does elect to exclude from his gross income for his tax year the gain attributable to \$20,000 of his adjusted sales price of his old residence. His selling price, selling expenses, fixing-up expenses, etc., are shown in the following computations:

Total Gain Realized	
1. Selling price of old residence.....	\$27, 000
2. Less: Selling expenses.....	1, 500
<hr/>	
3. Amount realized.....	\$25, 500
4. Less: Adjusted basis of old residence.....	18, 000
<hr/>	
5. Total gain realized.....	\$7, 500
<hr/>	
Adjusted Sales Price	
6. Amount realized (item 3).....	\$25, 500
7. Less fixing-up expenses.....	500
<hr/>	
8. Adjusted sales price.....	\$25, 000
<hr/>	

Gain Attributable to \$20,000 of Adjusted Sales Price He Elected to Exclude

9. Total gain realized (item 5)-----	\$7, 500
10. Less: Gain taxpayer elected to exclude from gross income	
\$20,000	
\$25,000	
----- $\times$ \$7,500-----	6, 000
11. Gain that taxpayer may NOT elect to EXCLUDE from gross income-----	<u>\$1, 500</u>

*Taxable portion of annuities.*—As a general rule, the taxable portion of an annuity involves a three-step process. First, the taxpayer must determine his exclusion percentage, which is computed by dividing his expected return into his investment, which is the amount of premiums he paid. If the taxpayer has a fixed-period annuity, his expected return is computed by multiplying the fixed number of years or months for which payments are to be made by the amount of the payment specified for each such period. In the case of an annuity for life, the expected return is determined by multiplying the amount of annual payment by a multiple (from the annuity tables) that is based on the taxpayer's life expectancy as of the annuity starting date.

Secondly, an individual would multiply his annual annuity income by the exclusion percentage, which would equal the pro rata return on his investment not included in income.

Thirdly, this amount is subtracted from the total annual annuity received, and the remainder would be taxable.

A special rule exists in instances where the annuitant will recover his investment within three years after receiving his first payment. In this case, the periodic amounts received are not taxable until the entire cost is recovered. Once the investment is recovered, the entire excess amount received is taxable.

*Example.*—Jack's annuity, with a net investment of \$9,000, pays him \$1,000 a year for life. The multiple he uses is 15.0 as shown in the Internal Revenue Service actuarial table for his age (male age 65), and his expected return is \$15,000 ( $15 \times \$1,000$ ). His investment of \$9,000 divided by his expected return of \$15,000 equals 60%, the percentage he will exclude. Each year Jack will exclude \$600 (60% of \$1,000) and consider \$400 as income, as long as payments are received.

*Three Year Rule Example.*—Evelyn Jones retired on January 31, 1967, with a monthly pension of \$200. Her pension cost was \$4,925. During the first 3 years she will receive \$7,200, which is more than her total cost. In 1967 Evelyn drew \$2,200 ( $\$200 \times 11$ ), which was tax-free. In 1968 she received \$2,400 which also was tax-free. However, in 1969, she is required to report \$2,075 as income, computed as follows:

Total pension received in 1969-----	\$2, 400
Cost: Her total contributions-----	\$4, 925
Less: Cost received tax free in 1967 and 1968 (\$2,200 plus \$2,400)-----	4, 600
Unrecovered cost-----	<u>325</u>
Amount of pension reportable as income in 1969-----	<u>\$2, 075</u>

*Sick pay exclusion.*—Persons who are absent from work because of sickness or injury and continue to receive taxable wages, may be entitled to exclude all or part of this amount from their gross income under certain circumstances.

In general, there is a waiting period—depending upon an individual's weekly rate of sick pay in comparison to his regular pay—before the taxpayer can exclude his pay while absent from work from his gross income.

A 30 day waiting period is required before any sick pay may be excluded when the worker's weekly rate of sick pay is in excess of 75 percent of his regular rate of pay.

If a nonhospitalized individual receives sick pay which does not exceed 75 percent of his regular rate of pay, only a 7 day waiting period is required.

No waiting period is necessary if the following two requirements are met:

(1) The taxpayer's weekly sick pay for the first 30 days of absence does not exceed 75 percent of his regular weekly wages, and

(2) He is hospitalized for at least one day during his absence.

For persons who are entitled to the exclusion during their first 30 days of absence, a three step computation is generally required:

—First, the taxpayer must determine his daily exclusion. This is his weekly rate of sick pay or \$75, whichever is lower, divided by the number of days in his normal work week.

—Secondly, the taxpayer counts his excludable days—the number of normal workdays that he is absent and for which he receives sick pay.

—Thirdly, he multiplies his daily exclusion by his excludable days.

An example will be used to illustrate this three stage calculation.

Facts: Jack works 6 days at \$90 a week. He is injured on Sunday May 31, 1970 and returns to work on Monday, June 22—after being absent from work for three weeks. During this absence he is hospitalized and receives \$60 per week in sick pay. Since he was hospitalized and his sick pay was less than 75 percent of his regular weekly wage (i.e.  $\$60/\$90=67\%$ ), no waiting period is required to exclude his sick pay from gross income. John's sick pay exclusion would be \$180, determined as follows:

(1) *Daily exclusion.* 
$$\frac{\text{Sick pay per week}}{\text{Number of days in normal work week}} \left( \frac{\$60}{6} = \$10 \text{ per day} \right)$$

(2) *Count excludable days.*—6 days in normal work week and absent for 3 weeks—18 excludable days.

(3) *Multiply daily exclusion (\$10) by excludable days (18).*—Sick Pay Exclusion equals \$180.

The sick pay exclusion after 30 days of absence follows a similar three step calculation. However, the maximum weekly rate of exclusion after 30 days is \$100, rather than \$75.

