

these plans. Employees with more than 3 years of service must be covered, and contributions on their behalf are fully deductible.

Under prior law, a self-employed individual could deduct from his gross income 50 percent of the contribution on his own behalf, and the contribution was limited to the smaller of 10 percent of his earned income or \$2,500. Accordingly, the maximum deduction allowed to a self-employed person with respect to his own contribution was \$1,250.

Earned income for this purpose was defined as the income received from the performance of personal services. When capital as well as personal services was a material factor in the production of the income, earned income could not exceed 30 percent of the net profits from the business (except that where an individual rendered personal services on a substantially full-time basis, this 30-percent rule could not reduce the net profits considered as earned income below \$2,500).

Explanation of provisions.—The act removes two limitations to the deduction.

First, the limitation of the deduction on behalf of a self-employed person to 50 percent of the contribution (10 percent of earned income up to a maximum of \$2,500) is repealed. This will permit the self-employed individual to deduct from his gross income the full amount of this contribution toward his own retirement, in the same manner as he does the full contribution he makes for his employees eligible for coverage. No change, however, is made in the limitation on the size of his contribution for himself; it remains at 10 percent of his earned income or \$2,500, whichever is smaller.

Second, the restriction is removed which limited the share of income considered “earned,” where both personal services and capital are important income-producing factors. The entire amount of net profits in such cases may be considered “earned.” It is provided, however, that in such cases the net profits involved with respect to any self-employed person are to be treated as earned income only in the case of a trade or business in which the personal services of the particular self-employed individual involved are a material income-producing factor. By this, it is contemplated that substantially full-time employment will be treated as a material income-producing factor. In the case of less than full-time employment, in determining whether the personal services of the taxpayer are a material income-producing factor there is to be taken into account the respective contribution made by his personal services and by his capital.

Effective dates.—The removal of the 50-percent limitation on the deductibility of contributions is to be effective with respect to taxable years beginning after December 31, 1967. No specific effective date was provided in the act for the provision regarding the treatment of earned income.

5. *Treatment of certain income of authors, inventors, etc., as earned income for retirement plan purposes (sec. 205 of the act and sec. 401(c) (2) of the code)*

Prior law.—Under the provisions which permit self-employed persons to deduct contributions (within specified limits) made to pension or profit-sharing plans for the benefit of themselves and other employees covered by a voluntary retirement plan, coverage depends on “earned income,” and such income is the basis for computing deductible contributions. This term includes professional fees and other com-