

tected by an economic system which provides that compensation be discriminatory in that it is based on the contribution of the individual. The third group, however, the middle income group, appears to fall short with respect to each of these protections. Indeed, a case could be made that this group should be afforded special "discriminatory" protections under the tax laws to offset the discrimination built into the Social Security system for lower-paid people; otherwise, companies will not be able to provide them with adequate retirement income, particularly when the rule we are dealing with seems to categorize them as highly compensated employees.

To sum up our discussion of discrimination, we think there is a clear danger of overstating that which is discriminatory by assuming that a rule prescribing benefit limits defines per se what is discriminatory.⁶ We think this is an oversimplification; while any rule which is developed along these lines may tend to prevent a discriminatory result, it is not certain to prevent it and, as in the case of the middle income group, may even aggravate it. In short, all the goal can ever be is to provide a very rough measure of equity and in a sense create a "ball park" test for rough justice as a means of keeping faith with the generally accepted principle that the tax laws should not be used to further "discrimination" of any kind.

THE CURRENT RULE AND A MATHEMATICAL APPROACH IN GENERAL

Since 1943 the Internal Revenue Service has provided a rule or set of rules setting out the limits governing integration of private plans with Social Security for tax qualification purposes. As Announcement 66-58 indicates, all the current rules stem from a mathematical formula devised to provide a means for comparing Social Security pensions with proposed private pensions. The first question then concerns the sufficiency of this test, currently the 37½-percent test.

To provide a basis for the comparisons that are the subject of the discussion which follows, the factors entering into determination of the current rule are outlined here:

1. Wage base of Social Security tax—\$4,800.
2. Maximum average monthly compensation under the Act—\$400.
3. The maximum "primary benefit" amount—\$127.
4. Total OASI benefits for an employee as a percent of the primary benefit (the former reflects disability, dependents' allowances, etc.)—150 percent.
5. Since the employee's and employer's contributions under the Act are equal, it could be assumed that an employee's contribution would approximate half the cost of the OASI benefits. However, most employees on retirement will have contributed less than half the cost of their own OASI benefits because of increases in OASI benefits since they came under the plan. Hence, an estimate must be made as to "actual" average employee contributions. This currently is 22 percent, making the employer's contribution 78 percent.

Using these "factors," calculation of the formula thus proceeds along the following lines:

1. $\frac{\$127}{400} = 32$ percent.
2. 32 percent x 150 percent = 48 percent.
3. 48 percent x 78 percent = 37.4 percent.

Rounded up, this is 37½ percent—the percentage of earnings above the Social Security wage base to which benefits under the integrated pension plan are limited if the plan is to be tax qualified. It is the rate which has prevailed using similar calculations since the Social Security wage base was at \$3,600. The principal change being suggested in the formula approach in Announcement 66-58 is that the employee contribution percentage be deemed to be 50 percent as opposed to the current 22 percent. Using this figure and basically the same formula approach as above, the rate becomes 24 percent. Although pension and actuarial expertise

⁶ While such a solution has serious drawbacks, the discrimination problem might also be handled on a case-by-case basis without an integration rule. Further, in searching for simplicity, one might turn to the classification rules and argue that if a group receiving a certain level of contributions or benefits is not a discriminatory group under the classification test it should not be discriminatory to provide it with special benefits under a pension plan. These suggestions, however, are not completely satisfactory answers because they are simply another way of saying "forget the integration rule." Such a course would be inequitable to those who have retired or will retire shortly under plans limited by the current rules. Perhaps more importantly, these thoughts are not wholly responsive to the issue to which the Service is directing its inquiry.