

advantage will be reduced ( $Z' < Z$ ), because of the number of parameters involved.<sup>11</sup> The attractiveness of the tax shelter in the "personal pension" deduction, though, is significantly reduced.

Taxpayers have other preferential tax treatment options in addition to this orthodox capital gains approach. The "personal pension" deduction should be compared with the next most attractive tax option to illustrate the relative net yield advantage, if any, of the deduction program. A comparison limited to the "personal pension" deduction versus the standard "no-tax-break," tax treatment ( $B/A$ ) certainly gives a distorted view of the relative attractiveness of the proposed pension scheme.

#### B. INVESTMENT AND LIQUIDITY CONSIDERATIONS

All aspects of investment other than the tax treatment of gross yields were assumed equal in comparing the yield advantages of tax options. In other words, the taxpayer was assumed to have complete freedom in his choice of investment. The preferential income tax options, then, would affect only net (after tax) yields.

In reality, preferential tax treatment may be combined with one or more investment constraints. These restrictions will reflect the intended policy objectives of the program. A principal object of both the current U.S. self-employed deduction and the Canadian universal pension deduction is to promote retirement saving—not speculative investment. Restrictions limiting the nature of investment and constraints against premature withdrawal before retirement, therefore, are consistent with the above goal. However, one must weigh these adverse features against any net yield advantage, if these constraints are unique to the "personal pension" deduction.

Both the U.S. and Canadian deductions prohibit "speculative" or personal business investment, to minimize the risk of principal. This restriction may be reasonable, but it imposes a risk-component stereotype on alternative forms of investment. Taxpayers may have "unapproved" investment opportunities generating greater gross yields (discounted for risk premiums) than permitted investment. Our illustrative taxpayer may have an opportunity to invest in real estate with an expected effective net yield of 6.50 percent under capital gains, instead of the 5.30 percent effective yield from corporate bonds under the "personal pension" deduction. The capital gains option presently is available to the taxpayer; if he chooses this route, the "personal pension" deduction will not have increased the rate of personal savings.

Moreover, independent businessmen and farmers by nature may be risk takers, and, therefore, may choose to gamble on business expansion even if one could demonstrate that expected returns from the alternative "personal pension" deduction were greater. But, the important consideration again is that nonpermitted forms of investment may

<sup>11</sup>  $Z' < Z$  if  $1 - \frac{t}{2} \left[ 1 + \frac{1}{(1+i)^n} \right] > \left[ 1 - \frac{iq}{1+i} \right]^n$ .