

and if the earnings of the pension fund were also taxed, the employer would have to pay \$194 a year in wages to enable the worker to buy his \$100-a-month pension.

If, as permitted under present rules, the employer makes contributions directly to the pension fund not subject to tax, and if the earnings of the fund are also free from tax, a pension of \$100 a month can be financed with an annual contribution of \$136. The cost is only 70 percent as much as in the first example because of the twofold saving on the corporate contribution and on the earnings of the fund.⁸

Appendix II hereof is an extended development of the "cost" demonstration of appendix B of the Cabinet Committee report displaying the theoretical benefit of deferred taxation for a 25-year, as well as a 40-year, accumulation period and with respect to several different situations.

The two situations described in the two foregoing quoted paragraphs are called case I and case III, respectively, in appendix B of the Cabinet Committee report. (The same identification is used in appendix II of this paper.) The stated "70 percent" relationship gives an exaggerated picture mainly because the average period of accumulation is probably no more than 25 years (not 40 years) and also because the formula in the report (p. 5 of appendix B.) for case I is incorrect in that the assumed income tax rate on investment earnings after retirement is taken as 18.5 percent (the same as before retirement) instead of 7½ percent, the stated basic assumption. For a 25-year accumulation period, the ratio of the case III figure to the case I figure is 78 percent; i.e., \$311.50 is 78 percent of \$400.50. The "cost" percentage relationship of case III to case I would be less if a higher interest rate than 4 percent were assumed; e.g., the 40-year period percentage of 72.5 percent (corrected from 70 percent), based on 4-percent interest, is 68.5 percent assuming a 5-percent interest rate. Furthermore, such percentages would be less for marginal income tax rates higher than 18.5 percent.

The Cabinet Committee report also illustrates the situation, case II, where the contribution is included in taxable income but tax on investment income is deferred to the retirement period. This is the status of employee contributions under qualified private plans (and also under plans covering Federal, State, and local government employees). The annual contribution to produce a net income of \$1,200 a year beginning at age 65 is \$163.50 on the 40-year basis as compared with \$136.50 for case III. As shown in appendix II hereof, such annual contribution on the 25-year basis is \$369.50 as compared with \$311.50 for case III.

In order to illustrate the theoretical benefit of deferred taxation alone, appendix II hereof presents figures for cases I(a), II(a), and III(a) which are the same as cases I, II, and III, respectively, except that the income tax rate assumed for the preretirement period; i.e., 18.5 percent, is also used for the postretirement period. The annual contribution to provide \$1,200 a year beginning at age 65 on the 25-year basis for these cases follows:

⁸ Report of President's Committee on Corporate Pension Funds, January 1965, p. 16.