

Case :	Annual contribution
I(a) -----	\$413. 50
II(a) -----	396. 00
III(a) -----	353. 50

Of the total reduction of \$60 (\$413.50—\$353.50), \$17.50 arises from the theoretical deferral of tax on investment income and \$42.50 from the theoretical deferral of tax on contributions. Then, assuming the 7½-percent income tax rate after retirement for case III(a) (thus making it case III), the annual contribution is \$311.50 or a further reduction of \$42 which includes the benefit of the lower 7½-percent tax rate that would apply in any event to investment income earned after retirement under case I.

Although the theoretical benefit of deferred taxation is frequently spoken of as arising solely from the lower income tax rates in retirement, it is evident that the mere deferment of tax on contributions and investment earnings is more important in these theoretical exercises than the difference in tax rates.

Appendix B of the Cabinet Committee report also presents "cost" figures for a "case IV, a pay-as-you-go plan." A hypothetical internal fund is assumed that earns 4 percent interest, but is taxed at a rate of 31 percent, "taking into account the dividend received deduction, tax-free interest, etc.," resulting in an assumed earnings rate of 2.76 percent. It is then concluded that an annual payment of \$201, on a 40-year basis, is required to produce \$1,200 a year and that an annual payment of \$100 would produce \$600 a year beginning at age 65. The basic interest assumption of 4 percent, less 31 percent of tax, is entirely improper and unrealistic since an employer, financing a plan on a pay-as-you-go basis, and setting up balance sheet reserves, may be considered, for this purpose, to enjoy the net rate of return of the funds invested in the business (i.e., after income tax) which may reasonably be expected to be at least 4 percent, much less 2.76 percent, for many employers.

In Mr. Surrey's statement before the Subcommittee on Fiscal Policy, he sought to depict the favorable tax treatment of the employer by comparing a qualified funded plan with a nonqualified funded plan. He said:

Under a qualified pension plan, an employer may deduct the amount of his contributions to the plan, subject to limitations on overfunding. As noted above, the investment income of the fund is tax free.

If a nonqualified plan does not have immediate vesting, the law does not permit deductibility of current contributions. If the nonqualified plan has such vesting, then the current contributions are deductible.

Through the deductibility of contributions of a qualified plan and the tax exemption of investment income, the Government is sharing pension costs with the employer. Consequently, *the employer is able to provide a given level of benefits at about half the cost of a nonqualified, nonvested plan.*⁹ [Emphasis added.]

⁹ Ibid., pp. 413-414.