

current deductions for borrowing charges coupled with the taxation of interest earnings on savings. This announcement effect can be mitigated by permitting special income tax treatment of selected transactions, thereby increasing net (after tax) yields on taxpayer investment. This difference in net yields is the stimulus for increased personal savings. Response will depend on the interest elasticity of personal savings to changes in net yields and, of course, the magnitude of change in yield.

Assume that an individual intends to save \$400 from gross income. Income taxes first must be paid and \$260 will remain as the basis of retirement saving if our taxpayer faces a 30-percent marginal tax rate. The taxpayer invests in 6-percent corporate bonds, subject to an annual levy on current earnings of the same 30-percent marginal tax rate. If our saver presently is 35 years old, his final fund at age 65 from this single contribution will be \$962. In order to compare alternative tax effects, we must relate this final fund to the initial gross saving of \$400. Our individual finds that, because of his income taxes, his effective net (after tax) yield is 2.97 percent on his initial \$400.

Now assume that the individual can deduct his allowable personal pension saving from current taxable income, thereby avoiding any present tax liability. Second, earnings on investment are subject to tax only at ultimate withdrawal. Taxes also are levied on the original principal on withdrawal. Our figurative saver can now invest his entire \$400 in the same 6-percent corporate bonds. He will find at the end of 30 years that his gross final fund has grown to \$2,297. Our individual now must include these moneys in reportable income at time of withdrawal. Assume that the entire final fund is withdrawn at age 65 and that the individual marginal tax rate is 18 percent. This reduced marginal tax rate reflects the pensioner situation of lower total reportable income in retirement years. For his efforts, the taxpayer now has \$1,884 net purchasing power at withdrawal. This represents an effective net (after tax) yield of 5.30 percent on the original \$400 gross intended saving.

However, a taxpayer is not restricted to these two income tax alternatives: there are other attractive options to increase net (after tax) yields. Capital gains is a familiar alternative. In the capital gains as in the standard approach, an individual establishing a retirement saving fund first must pay income taxes on current earnings before investment. If the interim earnings on principal are not realized for tax purposes until retirement, these sheltered earnings will be subject to a capital gains marginal tax rate. Using the same illustrative parameters as in the first two tax options, our taxpayer will realize a \$1,409 net final fund, or an effective net (after tax) yield of 4.29 percent. Taxpayers have other preferential tax treatment options in addition to this orthodox capital gains approach.

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 United States self-employed deduction and the Canadian universal pension deduction is to promote retirement savings—not speculative investment. Restrictions limiting the nature of investment and constraints against premature withdrawal before retirement, therefore,