

The application of the lifetime income spreading principle to the OASDI system would call for the tax deductibility of employee tax contributions along with the inclusion of benefits in taxable income. For persons who have no taxable income from which to deduct the social security tax contribution, and actual tax credit should be provided based on the initial marginal tax rate, now 14 percent. This tax deductible arrangement is more favorable, of course, at the higher levels of earnings than at the lower levels because of the progressive income tax rates. Those in higher income brackets, however, would be those persons, generally, who would in fact pay a tax on their social security benefits when received, thus producing a substantial order of equity. The need for recognition of past social security tax contributions would be achieved by, say, including benefits in taxable income only after they have been in receipt for 1 year; however, the vast majority of present recipients have received tax-free benefits in excess of their tax contributions paid from taxable income.

If the occasion arises when serious consideration is being given by the Congress to general revenue support for the OASDI system, such tax treatment, aside from its own real merits, deserves first consideration as an appropriate liberalization that is a strain on general revenues but is more logical than direct general revenue support. If this change in the tax treatment of OASDI benefits and employee tax contributions were made at a time of a modest increase in gross tax contributions and a general increase in benefits, employee net tax contributions would remain substantially unchanged and the increase in benefits would make the taxation of benefits more acceptable (or less unacceptable) to those who have been receiving tax-free benefits.

Present law permits lump-sum settlements in lieu of a lifetime retirement income. Such a settlement is taxed as a long-term capital gain under employer-employee plans provided, generally, that 100 percent of the pension value is taken. So far as serving the end of providing old-age life income, the law is deficient on two counts: First, it is wasteful in that it virtually compels the cancellation of all retirement income values in order to enjoy the capital gain tax treatment; second, it fails to provide assurance that pension contributions, or a major part thereof, are irrevocably dedicated to providing old-age life income. In order to improve this situation, serious consideration should be given to adopting a tax treatment and limitation similar to those in Canada and the United Kingdom where no more than 25 percent of pension values may be taken as a lump sum. Although such lump sum is tax free in these countries, it would be fair to apply the tax treatment that now is in effect in the United States for SEITRA plans.

There is need to recognize that pension benefits provided under employer-instituted plans, while a form of compensation, represent deferred compensation that is quite different in character from current compensation, that is, salaries and wages, and are benefits that, under the doctrine of constructive receipt, should be includable in taxable income only when received. Such benefits are designed to serve a different economic purpose—not to provide current income but to provide retirement income. Their tax treatment should recognize their true and unique character. Any attempt to apply the tax principles that are appropriate for wages and voluntary savings derived therefrom is