SELF-EMPLOYED INDIVIDUALS' RETIREMENT ACT

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

FIRST SESSION

ON

H.R. 10

AN ACT TO ENCOURAGE THE ESTABLISHMENT OF VOLUNTARY PENSION PLANS BY SELF-EMPLOYED INDIVIDUALS

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SELF-EMPLOYED INDIVIDUALS' RETIREMENT ACT

TUESDAY, JULY 25, 1961

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2221, New Senate Office Building, Hon. Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Long, Anderson, Douglas, Gore, McCarthy, Hartke, Williams, Carlson, Bennett, and Curtis.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The hearing today is on the act H.R. 10.

(The bill referred to is as follows:)

[H.R. 10. 87th Cong., 1st sess.]

AN ACT To encourage the establishment of voluntary pension plans by self-employed individuals

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Self-Employed Individuals Tax Retirement Act of 1961".

SEC. 2. QUALIFICATION OF PLANS.

Section 401 of the Internal Revenue Code of 1954 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended—

(1) by adding at the end of paragraph (5) of subsection (a) the following new sentence: "For purposes of this paragraph and subsection (d) (5), to total compensation of an individual who is a self-employed individual (as defined in subsection (c) (2)) is such individual's self-employment earnings (as defined in subsection (c) (3)) and the basic or regular rate of compensation of such an individual shall be determined, under regulations prescribed by the Secretary or his delegate, with respect to that portion of his self-employment earnings which bears the same ratio to his self-employment earnings as the basic or regular compensation of the employees (other than self-employed individuals) under the plan bears to the total compensation of such employees.";

(2) by adding at the end of subsection (a) the following new paragraphs:

"(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, upon its termination or upon complete discontinuance of contributions under the plan, the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or the amounts credited to the employees' accounts, are nonforfeitable. This paragraph shall not apply to benefits or contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by paragraph (4), may not be used for designated employees in the event of early termination of the plan.

"(8) A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the entire interest of each employee—

"(A) either will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or, in the case of an employee other than an owner-employee (as defined in subsection (c) (4)), in which he retires, whichever is the later, or

"(B) will be distributed, commencing not later than such taxable year, (i) in accordance with regulations prescribed by the Secretary or his delegate, over the life of such employee or over the lives of such employee and his spouse, or (ii) in accordance with such regulations, over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and his spouse.

"(9) A trust forming part of a pension plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

"(10) If—

"(A)(i) on one day in each quarter in the taxable year of the plan, an employer has more than 3 employees, or

"(ii) this paragraph applied at any prior time in respect of such plan, and

"(B) the plan provides for current or future contributions for any owner-employe,

then the trust shall be a qualified trust under this section only if each employee having a period of employment of 3 years or more is included under the plan. For purposes of the preceding sentence, (i) the term 'employee' does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year, nor does such term include an owner-employee, and (ii) in the case of a partner who is not an owner-employee, the period of time during which he has been such a partner shall be included in his period of employment.

"(11) If paragraph (10) does not apply and the plan benefits owner-employees, then the determination as to whether a trust is a qualified trust shall be made under this section—

"(A) if such plan benefits only owner-employees, without regard to the fact that such plan does not benefit employees other than owner-employees; and

"(B) if such plan also benefits employees other than owner-employees—

"(i) with respect to the portion of the plan which benefits employees other than owner-employees, without reference to the portion of the plan which benefits owner-employees, and

"(ii) with respect to the portion of the plan which benefits owner-employees, without reference to the portion of the plan which benefits employees other than owner-employees.

"(12) A trust forming part of a plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(4) shall constitute a qualified trust under this section only if the requirements in subsection (d) are also met."; and

(3) by redesignating subsection (c) as subsection (h) and inserting after subsection (b) the following new subsections:

"(c) DEFINITIONS AND RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—For purposes of this section—

"(1) EMPLOYEE.—The term 'employee' includes, for any taxable year, a self-employed individual.

"(2) SELF-EMPLOYED INDIVIDUAL.—The term 'self-employed individual' means an individual who has self-employment earnings (as defined in paragraph (3)) for the taxable year.

"(3) SELF-EMPLOYMENT EARNINGS.—The term 'self-employment earnings' means net earnings from self-employment (as defined in section 1402(a)) determined—

"(A) without regard to paragraphs (4) and (5) of section 1402(c),

"(B) in the case of any individual who is treated as an employee under section 3121(d) (3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

"(C) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

"(4) OWNER-EMPLOYEE.—The term 'owner-employee' means a self-employed individual who—

"(A) derives self-employment earnings from a trade or business carried on by him, or

"(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

"(5) EMPLOYER.—In the case of a trade or business carried on by a self-employed individual, such individual shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

"(d) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

"(1) In the case of a trust which is created on or after the date of the enactment of this subsection, or which was created before such date but is not exempt from tax under section 501(a) as an organization described in subsection (a) on the day before such date, the trustee is a bank, but a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, and exchanges). This paragraph shall not apply to a trust created or organized outside the United States before the date of the enactment of this subsection if, under section 402(c), it is treated as exempt from taxation under section 501(a) on the day before such date. For purposes of this paragraph, the term 'bank' means—

"(A) a bank as defined in section 581,

"(B) a corporation which under the laws of the State of its incorporation is subject to supervision and examination by the commissioner of banking or other officer of such State in charge of the administration of the banking laws of such State, and

"(C) in the case of a trust created or organized outside the United States, a bank or trust company, wherever incorporated, exercising fiduciary powers and subject to supervision and examination by governmental authority.

"(2) Under the plan, no benefits may be paid to any owner-employee before he attains the age of 59½ years, except in the case of his becoming disabled (within the meaning of section 213(g) (3).

"(3) If subsection (a)(10) applies, the employees' rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan.

"(4) In the case of a profit-sharing plan, the plan provides a definite formula for determining the contributions to be made to the trust by the employer on behalf of employees (other than owner-employees).

"(5) If subsection (a)(10) applies, the plan does not permit the ratio of contributions by the employer for any owner-employee to such owner-employee's compensation to exceed the ratio of contributions by the employer for any employee (other than an owner-employee) to his compensation. For purposes of this paragraph—

"(A) The term 'compensation' means total compensation, or basic or regular rate of compensation, whichever may be specified in the plan.

"(B) If—

"(i) of the contributions deductible under section 404, not more than one-third is deductible by reason of contributions by the employer for owner-employees, and

"(ii) taxes paid by the owner-employee under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employee but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer for such owner-employee,

then taxes paid under section 3111 (relating to tax on employers) with respect to an employee may be taken into account as contributions by the employer for such employee under the plan.

"(6) The plan does not permit—

"(A) contributions to be made by the employer for any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year;

"(B) in the case of a plan (or, if subsection (a)(11) applies, the portion thereof) which provides contributions or benefits only for owner-employees, contributions by or for any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year; and

"(C) if a distribution under the plan is made to any employee and if any portion of such distribution is an amount described in section 72(m)(5)(A)(i), contributions to be made on behalf of such employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

"(7) Under the plan, if an owner-employee dies before his entire interest has been distributed to him, or if distribution has been commenced in accordance with subsection (a)(8)(B) to his surviving spouse and such surviving spouse dies before his entire interest has been distributed to her, his entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of his surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which will be immediately distributed to such beneficiary or beneficiaries.

"(8) Under the plan—

"(A) any contribution which is an excess contribution (as defined in subsection (e)(1)), together with the income attributable to such excess contribution, is (unless subsection (e)(2)(E) applies) to be repaid to the owner-employee by or for whom such excess contribution is made;

"(B) if for any taxable year the plan does not, by reason of subsection (e)(2)(A), meet (for purposes of section 404) the requirements of this subsection with respect to an owner-employee, the income for the taxable year attributable to the interest of such owner-employee under the plan is to be paid to such owner-employee; and

"(C) the entire interest of an owner-employee is to be repaid to him when required by the provisions of subsection (e)(2)(E).

"(9)(A) If the plan provides contributions or benefits for an owner-employee who controls, or for two or more owner-employees who together control, the trade or business with respect to which the plan is established, and who also control as an owner-employee or as owner-employee one or more other trades or businesses, such plan and the plans (if any) established with respect to such other trades or businesses constitute a plan which meets the requirements of paragraphs (3) and (4), and paragraph (10) or (11) (as the case may be), of subsection (a) with respect to the employees of all such trades or businesses (including the trade or business with respect to which the plan intended to qualify under this section is established).

"(B) For purposes of subparagraph (A), an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

"(i) own the entire interest in an unincorporated trade or business, or

"(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of the preceding sentence, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-

employee or such two or more owner-employees, are considered to control within the meaning of the preceding sentence.

"(10) Under the plan, contributions by or for any owner-employee may be made only with respect to the self-employment earnings of such owner-employee derived from the trade or business with respect to which such plan is established.

"(e) EXCESS CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—

"(1) EXCESS CONTRIBUTION DEFINED.—For purposes of this section, the term 'excess contribution' means—

"(A) if, in the taxable year, contributions are made under the plan (or, if subsection (a)(11) applies, under the portion of the plan) only by or for owner-employees, the amount of any contribution made by or for any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year; or

"(B) if subparagraph (A) does not apply—

"(i) the amount of any contribution made by the employer for any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year;

"(ii) the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees; and

"(iii) the amount of any contribution made under the plan by any owner-employee (as an employee) which exceeds the lesser of $2,500 or 10 percent of the self-employment earnings for such taxable year derived by such owner-employee from the trade or business (or trades and businesses) with respect to which the plan is established; and

"(C) the amount of any contribution made by or for an owner-employee in any taxable year for which, under paragraph (2)(A) or (E), the plan does not (for purposes of section 404) meet the requirements of subsection (d) with respect to such owner-employee.

For purposes of this subsection, the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

"(2) EFFECT OF EXCESS CONTRIBUTION.—

"(A) IN GENERAL.—If an excess contribution (other than an excess contribution to which subparagraph (E) applies) is made by or for an owner-employee in any taxable year, the plan with respect to which such excess contribution is made shall, except as provided in subparagraphs (C) and (D), be considered, for purposes of section 404, as not meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year and for all succeeding taxable years.

"(B) INCLUSION OF AMOUNTS IN GROSS INCOME OF OWNER-EMPLOYEES.—For any taxable year for which any plan does not meet the requirements of subsection (d) with respect to an owner-employee by reason of subparagraph (A), the gross income of such owner-employee shall, for purposes of this chapter, include the amount of income for such taxable year attributable to the interest of such owner-employee under such plan.

"(C) REPAYMENT WITHIN PRESCRIBED PERIOD.—Subparagraph (A) shall not apply to an excess contribution with respect to any taxable year, if, on or before the close of the 6-month period beginning on the day on which the Secretary or his delegate sends notice (by certified or registered mail) to the person to whom such excess contribution was paid of the amount of such excess contribution, the amount of such excess contribution, and the income attributable thereto, is repaid to the owner-employee by or for whom such excess contribution was made. If the excess contribution is an excess contribution as defined in paragraph (1)(A) or (B)(i), or is an excess contribution as defined in paragraph (1)(C) with respect to which a deduction has been claimed under section 404, the notice required by the preceding sentence shall not be mailed prior to the time that the amount of the tax under this chapter of such owner-employee for the taxable year in which such excess contribution was made has been finally determined.

"(D) REPAYMENTS AFTER PRESCRIBED PERIOD.—If an excess contribution, together with the income attributable thereto, is not repaid within the 6-month period referred to in subparagraph (C), subparagraph (A) shall not apply to an excess contribution with respect to any taxable year beginning with the taxable year in which the person to whom such excess contribution was paid repays the amount of such excess contribution to the owner-employee by or for whom such excess contribution was made, and pays to such owner-employee the amount of income attributable to the interest of such owner-employee which, under subparagraph (B), has been included in the gross income of such owner-employee for any prior taxable year.

"(E) SPECIAL RULE IF EXCESS CONTRIBUTION WAS WILLFULLY MADE.—If an excess contribution made by or for an owner-employee is determined to have been willfully made, then—

"(i) subparagraphs (A), (B), (C), and (D) shall not apply with respect to such excess contribution;

"(ii) there shall be distributed to the owner-employee by or for whom such excess contribution was willfully made his entire interest in all plans with respect to which he is an owner-employee; and

"(iii) no plan shall, for purposes of section 404, be considered as meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year in which it is determined that such excess contribution was willfully made and for the 5 taxable years following such taxable year.

"(F) STATUTE OF LIMITATIONS.—If any case in which subparagraph (A) applies, the period for assessing any deficiency arising by reason of—

"(i) the disallowance of any deduction under section 404 on account of a plan not meeting the requirements of subsection (d) with respect to the owner-employee by or for whom an excess contribution was made, or

"(ii) the inclusion, under subparagraph (B), in gross income of such owner-employee of income attributable to the interest of such owner-employee under a plan,

for the taxable year in which such excess contribution was made or for any succeeding taxable year shall not expire prior to one year after the close of the 6-month period referred to in subparagraph (C).

"(f) CERTAIN CUSTODIAL ACCOUNTS.—

"(1) TREATMENT AS QUALIFIED TRUST.—For purposes of this title a custodial account shall be treated as a qualified trust under this section, if—

"(A) such custodial account would, except for the fact that it is not a trust, constitute a qualified trust under this section;

"(B) the custodian is a bank (as defined in section 581);

"(C) the investment of the funds in such account (including all earnings) is to be made solely in regulated investment company stock with respect to which an employee is the beneficial owner; and

"(D) the shareholder of record of any such stock is the custodian or its nominee.

For purposes of this title, in the case of a custodial account treated as a qualified trust under this section by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

"(2) DEFINITION.—For purposes of paragraph (1), the term 'regulated investment company' means a domestic corporation which—

"(A) is a regulated investment company within the meaning of section 851(a), and

"(B) issues only redeemable stock.

"(g) FACE-AMOUNT CERTIFICATES TREATED AS ANNUITIES.—For purposes of this section and sections 402, 403, and 404, the term 'annuity' includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a-2), which is nontransferable."

SEC. 3. DEDUCTIBILITY OF CONTRIBUTIONS TO PLANS.

(a) INCLUSION OF SELF-EMPLOYED INDIVIDUALS.—Section 404(a) of the Internal Revenue Code of 1954 (relating to the deductibility of contributions to pension, annuity, profit-sharing, or stock bonus plans or plans of deferred compensation) is amended—

(1) by striking out "section 401(a) (3), (4), (5), and (6)," in paragraph (2) and inserting in lieu thereof "section 401(a) (other than paragraphs (1), (2), and (12)) and, in the case of a plan described in pargaraph (9) of this subsection, which meets the requirements of section 401(d) (other than paragraphs (1) and (4))," ; and

(2) by adding after pargaraph (7) the following new paragraphs:

"(8) SELF-EMPLOYED INDIVIDUALS.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for self-employed individuals within the meaning of section 401(c)(2), for purposes of this section—

"(A) the term 'employee' includes a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual is the person treated as his employer under section 401(c)(5);

"(B) the term 'self-employment earnings' has the meaning assigned to it by section 401(c)(3);

"(C) the contributions to such plan by or for a self-employed individual shall be considered to satisfy the conditions of section 162 or 212 to the extent that such contributions do not exceed the self-employment earnings of such individual derived from the trade or business with respect to which such plan is established, and to the extent that such contributions are not allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance; and

"(D) any reference to compensation shall, in the case of a self-employed individual, be considered to be a reference to the self-employment earnings of such individual derived from the trade or business with respect to which the plan is established.

"(9) PLANS BENEFITING OWNER-EMPLOYEES.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are owner-employees—

"(A) the limitations provided by pargaraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees (other than owner-employees), as if such employees were the only employees for whom contributions and benefits are provided under the plan;

"(B) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of owner-employees—

"(i) as if such owner-employees were the only employees for whom contributions and benefits are provided under the plan, and

"(ii) without regard to paragraph (1)(D), the second and third sentences of paragraph (3), and the second sentence of pargaraph (7); and

"(C) the amounts deductible under paragraphs (1), (2), (3), and (7), with respect to contributions on behalf of any owner-employee, shall not exceed the applicable limitation provided in subsection (e).

For purposes of this paragraph and subsections (e) and (f), the term 'owner-employee' has the meaning assigned to it by section 401(c)(4)."

(b) LIMITATIONS ON DEDUCTIONS FOR CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—Section 404 of the Internal Revenue Code of 1954 (relating to the deductibility of contributions to pension, annuity, profit-sharing, or stock bonus plans or plans of deferred compensation) is amended by adding after subsection (d) the following new subsections:

"(e) SPECIAL LIMITATIONS FOR OWNER-EMPLOYEES.—

"(1) IN GENERAL.—In the case of a plan included in subsection (a) (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are owner-employees, the amounts deductible under subsection (a) in any taxable year with respect to contributions on behalf of any owner-employee shall not exceed—

"(A) except as provided in subpargaraph (B), $2,500, or 10 percent of the self-employment earnings derived by such owner-employee from the trade or business with respect to which the plan is established, whichever is the lesser; or

"(B) if section 401(a)(10) applies, the maximum amount of contributions permitted on behalf of such owner-employee on the application of section 401(d)(5).

"(2) CONTRIBUTIONS MADE UNDER MORE THAN ONE PLAN.—

"(A) OVERALL LIMITATION.—In any taxable year in which amounts are deductible with respect to two or more plans (whether established with respect to the same trade or business or different trades or businesses) on behalf of an individual who is an owner-employee with respect to such plans, the aggregate amount deductible for such taxable year under such plans with respect to contributions on behalf of such owner-employee shall not exceed whichever of the following amounts is the greater:

"(i) $2,500, or

"(ii) the sum of the amounts so contributed under all such plans to the extent that, with respect to each such plan, the amount contributed does not exceed the amount described in paragraph (1)(B).

"(B) ALLOCATION OF AMOUNTS DEDUCTIBLE.—In any case in which the amounts deductible under subsection (a) (with the application of the limitations of this subsection) with respect to contributions made by or for an owner-employee under two or more plans are, by reason of subparagraph (A), less than the amounts deductible under such subsection determined without regard to such subparagraph, the amount deductible under subsection (a) with respect to such contributions under each such plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

"(3) CONTRIBUTIONS ALLOCABLE TO INSURANCE PROTECTION.—For purposes of this subsection, contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

"(f) CERTAIN LOAN REPAYMENTS CONSIDERED AS CONTRIBUTIONS.—For purposes of this section, any amount paid, directly or indirectly, by an owner-employee in repayment of any loan which under section 72(m)(4)(B) was treated as an amount received under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as a part of a plan described in section 403(a) shall be treated as a contribution to which this section applies on behalf of such owner-employee to such trust or to or under such plan."

SEC. 4. TAXABILITY OF DISTRIBUTIONS.

(a) EMPLOYEES' ANNUITIES.—Section 72(d)(2) of the Internal Revenue Code of 1954 (relating to employees' annuities) is amended to read as follows:

"(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1)—

"(A) if the employee died before any amount was received as an annuity under the contract, the words 'receivable by the employee' shall be read as 'receivable by a beneficiary of the employee'; and

"(B) any contribution made with respect to the contract while an individual is a self-employed individual within the meaning of section 401(c)(2) which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee."

(b) SPECIAL RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—Section 72 of the Internal Revenue Code of 1954 (relating to annuities, etc.) is amended by redesigning subsection (m) as subsection (o) and by inserting after subsection (l) the following new subsections:

"(m) SPECIAL RULES APPLICABLE TO EMPLOYEE ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE PLANS.—

"(1) CERTAIN AMOUNTS RECEIVED BEFORE ANNUITY STARTING DATE.—Any amounts received under an annuity, endowment, or life insurance contract before the annuity starting date which are not received as an annuity (within the meaning of subsection (e)(2)) shall be included in the recipient's gross income for the taxable year in which received to the extent that—

"(A) such amounts, plus all amounts theretofore received under the contract and includible in gross income under this paragraph, do not exceed

"(B) the aggregate premiums or other consideration paid for the contract while the employee was an owner-employee (as defined in section 401(c)(4)) which were allowed as deductions under section 404 for the taxable year and all prior taxable years (not including any por-

tion of such premiums or other consideration properly allocable, as determined under regulations prescribed by the Secretary or his delegate, to the cost of life, accident, health, or other insurance).

Any such amounts so received which are not includible in gross income under this paragraph shall be subject to the provisions of subsection (e).

"(2) COMPUTATION OF CONSIDERATION PAID BY THE EMPLOYEE.—In computing—

"(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract),

"(B) the consideration for the contract contributed by the employee for purposes of subsection (d)(1) (relating to employee's contributions recoverable in 3 years), and

"(C) the aggregate premiums or other consideration paid for purposes of subsection (e)(1)(B) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the individual was a self-employed individual within the meaning of section 401(c)(2) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the individual was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary or his delegate) to the cost of life, accident, health, or other insurance.

"(3) LIFE INSURANCE CONTRACTS.—

"(A) This paragraph shall apply to any life insurance contract—

"(i) purchased as a part of a plan described in section 403(a), or

"(ii) purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

"(B) Any contributions to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404, and any income of a trust described in subparagraph (A)(ii), which is determined in accordance with regulations prescribed by the Secretary or his delegate to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.

"(C) In the case of the death of an individual insured under a contract described in subparagraph (A), an amount equal to the cash surrender value of the contract immediately before the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101.

"(4) AMOUNTS CONSTRUCTIVELY RECEIVED.—

"(A) ASSIGNMENTS OR PLEDGES.—If during any taxable year an owner-employee assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a trust described in section 401(a) which is exempt from tax under section 501(a) or any portion of the value of a contract purchased as part of a plan described in section 403(a), such portion shall be treated as having been received by such owner-employee as a distribution from such trust or as an amount received under the contract.

"(B) LOANS ON CONTRACTS.—If during any taxable year, an owner-employee receives, directly or indirectly, any amount from any insurance company as a loan under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as part of a plan described in section 403(a), and issued by such insurance company, such amount shall be treated as an amount received under the contract.

"(5) PENALTIES APPLICABLE TO CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.—

"(A) This paragraph shall apply—

"(i) to amounts (other than any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution) which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) and which are received by an individual, who is, or has been, an owner-employee, before such individual attains the age of 59½ years, for any reason other than the individual's becoming disabled (within the meaning of section 213(g)(3)), but only to the extent that such amounts are attributable to contributions paid on behalf of such individual (whether or not paid by him) while he was an owner-employee,

"(ii) to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, an owner-employee, or by the successor of such individual, but only to the extent that such amounts are determined, under regulations prescribed by the Secretary or his delegate, to exceed the benefits provided for such individual under the plan formula, and

"(iii) to amounts which are received, by reason of the distribution under the provisions of section 401(e)(2)(E), by an individual who is, or has been, an owner-employee of his entire interest in all qualified trusts described in section 401(a) and in all plans described in section 403(a).

"(B)(i) If the aggregate of the amounts to which this paragraph applies received by any person in his taxable year equals or exceeds $2,500, the increase in his tax for the taxable year in which such amounts are received and attributable to such amounts shall not be less than 110 percent of the aggregate increase in taxes, for the taxable year and the 4 immediately preceding taxable years, which would have resulted if such amounts had been included in such person's gross income ratably over such taxable years.

"(ii) If deductions have been allowed under section 404 for contributions paid on behalf of the individual while he is an owner-employee for a number of prior taxable years less than 4, clause (i) shall be applied by taking into account a number of taxable years immediately preceding the taxable year in which the amount was so received equal to such lesser number.

"(C) If subparagraph (B) does not apply to a person for the taxable year, the increase in tax of such person for the taxable year attributable to the amounts to which this paragraph applies shall be 110 percent of such increase (computed without regard to this subparagraph).

"(D) Subparagraph (A)(ii) of this paragraph shall not apply to any amount to which section 402(a)(2) or 403(a)(2) applies.

"(E) Subsection (n)(3) shall apply for purposes of computing taxable income for each taxable year to which this paragraph applies.

"(6) OWNER-EMPLOYEE DEFINED.—For purposes of this subsection, the term 'owner-employee' has the meaning assigned to it by section 401(c)(4).

"(n) TREATMENT OF CERTAIN DISTRIBUTIONS WITH RESPECT TO CONTRIBUTIONS BY SELF-EMPLOYED INDIVIDUALS.—

"(1) APPLICATION OF SUBSECTION.—

"(A) DISTRIBUTION BY EMPLOYEES' TRUST.—Subject to the provisions of subparagraph (C), this subsection shall apply to amounts distributed to a distributee, in the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if the total distributions payable to the distributee with respect to an employee are paid to the distributee within one taxable year of the distributee—

"(i) on account of the employee's death,

"(ii) after the employee has attained the age of 59½ years, or

"(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

"(B) ANNUITY PLANS.—Subject to the provisions of subparagraph (C), this subsection shall apply to amounts paid to a payee. In the case of an annuity plan described in section 403(a), if the total amounts payable to the payee with respect to an employee are paid to the payee within one taxable year of the payee—

"(i) on account of the employee's death,

"(ii) after the employee has attained the age of 59½ years, or

"(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

"(C) LIMITATIONS AND EXCEPTIONS.—This subsection shall apply—

"(i) only with respect to so much of any distribution or payment to which (without regard to this subparagraph) subparagraph (A) or (B) applies as is attributable to contributions made by or for a self-employed individual within the meaning of section 401(c)(2), and

"(ii) if the recipient is the individual by or for whom such contributions were made, only if contributions which were allowed as a deduction under section 404 have been made by or for such individual while he was a self-employed individual within the meaning of section 401(c)(2) for 5 or more taxable years prior to the taxable year in which the total distributions payable or total amounts payable, as the case may be, are paid.

This subsection shall not apply to amounts described in clauses (ii) and (iii) of subpararaph (A) of subsection (m)(5) (but, in the case of amounts described in clause (ii) of such subparagraph, only to the extent that subsection (m)(5) applies to such amounts).

"(2) LIMITATION OF TAX.—In any case to which this subsection applies, the tax attributable to the amounts to which this subsection applies for the taxable year in which such amounts are received shall not exceed whichever of the following is the greater:

"(A) 5 times the increase in tax which would result from the inclusion in gross income of the recipient of 20 percent of so much of the amount so received as is includible in gross income, or

"(B) 5 times the increase in tax which would result if the taxable income of the recipient for such taxable year equalled 20 percent of the amount of the taxable income of the recipient for such taxable year determined under paragraph (3)(A).

"(3) DETERMINATION OF TAXABLE INCOME.—Notwithstanding section 63 (relating to definition of taxable income), for purposes only of computing the tax under this chapter attributable to amounts to which this subsection or subsection (m)(5) applies and which are includible in gross income—

"(A) the taxable income of the recipient for the taxable year of receipt shall be treated as being not less than the amount by which (i) the aggregate of such amount so includible in gross income exceeds (ii) the amounts of the deductions allowed for such taxable year under section 151 (relating to deductions for personal exemptions); and

"(B) in making ratable inclusion computations under paragraph (5)(B) of subsection (m), the taxable income of the recipient for each taxable year involved in such ratable inclusion shall be treated as being not less than the amount required by such paragraph (5)(B) to be treated as includible in gross income for such taxable year.

In any case in which the preceding sentence results in an increase in taxable income for any taxable year, the resulting increase in the taxes imposed by section 1 or 3 for such taxable year shall not be reduced by any credit under part IV of subchapter A (other than section 31 thereof) which, but for this sentence, would be allowable."

(c) CAPITAL GAINS TREATMENT OF CERTAIN EMPLOYEES' TRUSTS DISTRIBUTIONS.—Section 402(a) of the Internal Revenue Code of 1954 (relating to capital gains treatment for certain distributions) is amended by adding at the end of paragraph (2) the following new sentence: "This paragraph shall not apply to distributions paid to any distributee to the extent such distributions are attributable to contributions made by or for an individual while he was a self-employed individual within the meaning of section 401(c)(2)."

(d) CAPITAL GAINS TREATMENT OF CERTAIN EMPLOYEES' ANNUITY PAYMENTS.—Section 403(a) of the Internal Revenue Code of 1954 (relating to taxability of a beneficiary under a qualified annuity plan) is amended—

(1) by striking out in paragraph (2)(A)(i) "which meets the requirements of section 401(a) (3), (4), (5), and (6)" and inserting in lieu thereof "described in paragraph (1)";

(2) by adding at the end of paragraph (2)(A) the following new sentence: "This subparagraph shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made by or for an individual while he was a self-employed individual within the meaning of section 401(c)(2)."; and

(3) by adding after paragraph (2) the following new paragraph:

"(3) SELF-EMPLOYED INDIVIDUALS.—For purposes of this subsection, the term 'employee' includes an individual who is a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual is the person treated as his employer under section 401(c)(5)."

SEC. 5. PLANS FOR PURCHASE OF UNITED STATES BONDS.

(a) QUALIFIED BOND PURCHASE PLANS.—Part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 (relating to deferred compensation, etc.) is amended by adding at the end thereof the following new section:

"SEC. 405. QUALIFIED BOND PURCHASE PLANS.

"(a) REQUIREMENTS FOR QUALIFICATION.—A plan of an employer for the purchase for and distribution to his employees or their beneficiaries of United States bonds described in subsection (b) shall constitute a qualified bond purchase plan under this section if—

"(1) the plan meets the requirements of section 401(a) (other than paragraphs (1), (2), and (12)) and, if applicable, the requirements of section 401(d) (other than paragraphs (1), (6)(B), and (8)); and

"(2) contributions under the plan are used solely to purchase for employees or their beneficiaries United States bonds described in subsection (b).

"(b) BONDS TO WHICH APPLICABLE.—

"(1) CHARACTERISTICS OF BONDS.—This section shall apply only to a bond issued under the Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary under such Act—

"(A) provides for payment of interest, or investment yield, only upon redemption;

"(B) may be purchased only in the name of an individual;

"(C) ceases to bear interest, or provide investment yield, not later than 5 years after the death of the individual in whose name it is purchased;

"(D) may be redeemed before the death of the individual in whose name it is purchased only if such individual—

"(i) has attained the age of 59½ years, or

"(ii) has become disabled (within the meaning of section 213(g)(3)); and

"(E) is nontransferable.

"(2) MUST BE PURCHASED IN NAME OF EMPLOYEE.—This section shall apply to a bond described in paragraph (1) only if it is purchased in the name of the employee.

"(c) DEDUCTION FOR CONTRIBUTIONS TO BOND PURCHASE PLANS.—Contributions paid by an employer to or under a qualified bond purchase plan shall be deductible in an amount determined under section 404(a) in the same manner and to the same extent as if such contributions were made to a trust described in section 401(a) which is exempt from tax under section 501(a).

"(d) TAXABILITY OF BENEFICIARY OF QUALIFIED BOND PURCHASE PLAN.—

"(1) GROSS INCOME NOT TO INCLUDE BONDS AT TIME OF DISTRIBUTION.—For purposes of this chapter, in the case of a distributee of a bond described in subsection (b) under a qualified bond purchase plan, or from a trust described in section 401(a) which is exempt from tax under section 501(a), gross income does not include any amount attributable to the receipt of such bonds. Upon redemption of such bond, the proceeds shall be subject to taxation under this chapter, but the provisions of section 72 (relating to annuities, etc.) and section 1232 (relating to bonds and other evidences of indebtedness) shall not apply.

"(2) BASIS.—The basis of any bond received by a distributee under a qualified bond purchase plan—

"(A) if such bond is distributed to an employee, or with respect to an employee, who at the time of purchase of the bond, was not a self-employed individual within the meaning of section 401(c)(2), shall be the amount of the contributions by the employees which were used to purchase the bond, and

"(B) if such bond is distributed to an individual, or with respect to an individual, who, at the time of purchase of the bond, was a self-employed individual within the meaning of section 401(c)(2), shall be the amount of the contributions used to purchase the bond which were made by or for such individual and were not allowed as a deduction under subsection (c).

The basis of any bond described in subsection (b) received by a distributee from a trust described in section 401(a) which is exempt from tax under section 501(a) shall be determined under regulations prescribed by the Secretary or his delegate.

"(e) CAPITAL GAINS TREATMENT NOT TO APPLY TO BONDS DISTRIBUTED BY TRUSTS.—Section 402(a)(2) shall not apply to any bond described in subsection (b) distributed to any distributee and, for purposes of applying such section, any such bond distributed to any distributee and any such bond to the credit of any employee shall not be taken into account.

"(f) EMPLOYEE DEFINED.—For purposes of this section, the term 'employee' includes an individual who is a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual shall be the person treated as his employer under section 401(c)(5).

"(g) PROOF OF PURCHASE.—At the time of purchase of any bond to which this section applies, proof of such purchase shall be furnished in such form as will enable the purchaser, and the employee in whose name such bond is purchased, to comply with the provisions of this section.

"(h) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section."

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 405. Qualified bond purchase plans."

SEC. 6. PROHIBITED TRANSACTIONS.

Section 503 of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amendde by adding at the end thereof the following new subsection:

"(j) TRUSTS BENEFITING CERTAIN OWNER-EMPLOYEES.—

"(1) PROHIBITED TRANSACTIONS.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(4)) who control (within the meaning of section 401(d)(9)(B)), the trade or business with respect to which the plan is established, the term 'prohibited transaction' also means any transaction in which such trust, directly or indirectly—

"(A) lends any part of the corpus or income of the trust to;

"(B) pays any compensation for personal services rendered to the trust to;

"(C) makes any part of its services available on a preferential basis to; or

"(D) acquires for the trust any property from, or sells any property to;

any person described in subsection (c) or to any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

"(2) SPECIAL RULE FOR LOANS.—For purposes of the application of paragraph (1)(A), the following rules shall apply with respect to a loan made before the date of the enactment of this subsection which would be a prohibited transaction if made in a taxable year beginning after December 31, 1961:

"(A) If any part of the loan is repayable prior to December 31, 1964, the renewal of such part of the loan for a period not extending beyond

December 31, 1964, on the same terms, shall not be considered a prohibited transaction.

"(B) If the loan is repayable on demand, the continuation of the loan beyond December 31, 1964, shall be considered a prohibited transaction."

SEC. 7. OTHER SPECIAL RULES, TECHNICAL CHANGES, AND ADMINISTRATIVE PROVISIONS.

(a) RETIREMENT INCOME CREDIT.—Section 37(c)(1) of the Internal Revenue Code of 1954 (relating to definition of retirement income) is amended—

(1) by striking out subparagraph (A) and inserting in lieu thereof the following:

"(A) pensions and annuities (including, in the case of an individual who is, or has been, a self-employed individual within the meaning of section 401(c)(2), distributions by a trust described in section 401(a), which is exempt from tax under section 501(a))," ; and

(2) by striking out "and" at the end of subparagraph (C), by striking out "or" at the end of subparagraph (D) and inserting in lieu thereof "and," and by adding after subparagraph (D) the following new subparagraph:

"(E) bonds described in section 405(b)(1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), or".

(b) ADJUSTED GROSS INCOME.—Section 62 of the Internal Revenue Code of 1954 (relating to the definition of adjusted gross income) is amended by inserting after paragraph (6) the following new paragraph:

"(7) PENSION, PROFIT-SHARING, ANNUITY, AND BOND PURCHASE PLANS OF SELF-EMPLOYED INDIVIDUALS.—In the case of an individual who is a self-employed individual within the meaning of section 401(c)(2), the deductions allowed by section 404 and section 405(c) to the extent attributable to contributions made by or for such individual."

(c) DEATH BENEFITS.—Section 101(b) of the Internal Revenue Code of 1954 (relating to employees' death benefits) is amended—

(1) by striking out clause (ii) of paragraph (2)(B) and inserting in lieu thereof the following:

"(ii) under an annuity contract under a plan described in section 403(a), or"; and

(2) by adding at the end thereof the following new paragraph:

"(3) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this subsection, an individual shall not be treated as an employee in the case of—

"(A) a pension or profit-sharing trust described in section 401 (a) which is exempt from tax under section 501(a), or

"(B) an annuity contract under a plan described in section 403(a),

if such individual was included at any time under the plan as a self-employed individual within the meaning of section 401(c)(2)."

(d) AMOUNTS RECEIVED THROUGH ACCIDENT OR HEALTH INSURANCE.—Section 104(a) of the Internal Revenue Code of 1954 (relating to compensation for injuries or sickness) is amended by adding at the end thereof the following new sentence:

"For purposes of paragraph (3), in the case of an individual who is, or has been, a self-employed individual within the meaning of section 401(c)(2), contributions made by or for such individual while he was such an individual to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee."

(e) AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.—Section 105 of the Internal Revenue Code of 1954 (relating to amounts received under accident and health plans) is amended by adding at the end thereof the following new subsection:

"(g) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AS EMPLOYEE.—For purposes of this section, the term 'employee' does not include an individual who is a self-employed individual within the meaning of section 401(c)(2)."

(f) NET OPERATING LOSS DEDUCTION.—Section 172(d)(4) of the Internal Revenue Code of 1954 (relating to nonbusiness deductions of taxpayers other than corporations) is amended—

(1) by striking out "and" at the end of subparagraph (B);

(2) by striking out the period at the end of subparagraph (C) and inserting "; and"; and

(3) by adding after subparagraph (C) the following new subparagraph:

"(D) any deduction allowed under section 404 or section 405(c) to the extent attributable to contributions which are made on behalf of an individual who is a self-employed individual within the meaning of section 401(c)(2) shall not be treated as attributable to the trade or business of such individual."

(g) CERTAIN LIFE INSURANCE RESERVES.—Section 805(d)(1) of the Internal Revenue Code of 1954 (relating to pension plan reserves) is amended—

(1) by striking out in subparagraph (B) "meeting the requirements of section 401(a) (3), (4), (5), and (6) or" and inserting in lieu thereof "described in section 403(a), or plans meeting"; and

(2) by striking out "section 401(a) (3), (4), (5), and 6);" in subparagraph (C) and inserting in lieu thereof "section 401(a) (other than paragraphs (1), (2), and (12)) and, in the case of a plan described in section 404(a)(9), which meets the requirements of section 401(d) (other than paragraphs (1) and (4));".

(h) UNINCORPORATED BUSINESS ELECTING TO BE TAXED AS CORPORATIONS.—Section 1361(d) of the Internal Revenue Code of 1954 (relating to unincorporated business enterprises electing to be taxed as domestic corporations) is amended to read as follows:

"(d) LIMITATION.—For purposes of sections 401(a) (relating to employees pension trusts, etc.) and 405 (relating to qualified bond purchase plans), a partner or proprietor of an unincorporated business enterprise as to which an election has been made under subsection (a) shall not be considered an employee other than as a self-employed individual within the meaning of section 401(c)(2)."

(i) ESTATE TAX EXEMPTION OF EMPLOYEES' ANNUITIES.—Section 2039 of the Internal Revenue Code of 1954 (relating to exemption from the gross estate of annuities under certain trusts and plans) is amended—

(1) by striking out in subsection (c)(2) "met the requirements of section 401(a) (3), (4), (5), and (6)" and inserting "was a plan prescribed in section 403(a)"; and

(2) by adding at the end of subsection (c) the following new sentence: "For purposes of this subsection, contributions or payments on behalf of the decedent while he was a self-employed individual within the meaning of section 401(c)(2) made under a trust or plan described in paragraph (1) or (2) shall be considered to be contributions or payments made by the decedent."

(j) GIFT TAX EXEMPTION OF EMPLOYEES' ANNUITIES.—Section 2517 of the Internal Revenue Code of 1954 (relating to exclusion from gift tax in case of certain annuities under qualified plans) is amended—

(1) by striking out in subsection (a)(2) "met the requirements of section 401(a) (3), (4), (5), and (6)" and inserting in lieu thereof "was a plan described in section 403(a)"; and

(2) by adding at the end of subsection (b) the following new sentence: "For purposes of this subsection, payments or contributions on behalf of an individual while he was a self-employed individual within the meaning of section 401(c)(2) made under a trust or plan described in subsection (a)(1) or (2) shall be considered to be payments or contributions made by the employee."

(k) FEDERAL UNEMPLOYMENT TAX ACT.—Section 3306(b)(5) of the Internal Revenue Code of 1954 (relating to definition of wages) is amended by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a), or

"(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a);".

(l) WITHHOLDING OF INCOME TAX.—Section 3401(a)(12) of the Internal Revenue Code of 1954 (relating to definition of wages) is amended by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

"(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a)."

(m) INFORMATION REQUIREMENTS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6047. INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY AND BOND PURCHASE PLANS.

"(a) TRUSTEES AND INSURANCE COMPANIES.—The trustee of a trust described in section 401(a) which is exempt from tax under section 501(a), to which contributions have been paid under a plan by or for any owner-employee (as defined in section 401(c)(4)), and each insurance company or other person which is the issuer of a contract purchased by such a trust, or purchased under a plan described in section 403(a), contributions for which have been paid by or for any owner-employee, shall file such returns (in such form and at such times), keep such records, make such identification of contracts and funds (and accounts within such funds), and supply such information, as the Secretary or his delegate shall by forms or regulations prescribe.

"(b) OWNER-EMPLOYEES.—Every individual by or for whom contributions have been paid as an owner-employee (as defined in section 401(c)(4))—

"(1) to a trust described in section 401(a) which is exempt from tax under section 501(a), or

"(2) to an insurance company or other person under a plan described in section 403(a),

shall furnish the trustee, insurance company, or other person, as the case may be, such information at such times and in such form and manner as the Secretary or his delegate shall prescribe by forms or regulations.

"(c) EMPLOYEES UNDER QUALIFIED BOND PURCHASE PLANS.—Every individual in whose name a bond described in section 405(b)(1) is purchased by his employer under a qualified bond purchase plan described in section 405(a), or by a trust described in section 401(a) which is exempt from tax under section 501(a), shall furnish—

"(1) to his employer or to such trust, and

"(2) to the Secretary (or to such person as the Secretary may by regulations prescribe).

such information as the Secretary or his delegate shall by forms or regulations prescribe.

"(d) CROSS REFERENCE.—

"For criminal penalty for furnishing fraudulent information, see section 7207."

(2) CLERICAL AMENDMENT.—The table of sections for such subpart B is amended by adding at the end thereof the following:

"Sec. 6047. Information relating to certain trusts and annuity and bond plans."

(3) PENALTY.—Section 7207 of the Internal Revenue Code of 1954 (relating to fradulent returns, statements, or other documents) is amended by adding at the end thereof the following new sentence: "Any person required pursuant to section 6047 (b) or (c) to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary or such other person any information known by him to be fraululent or to be false as to any material matter shall be fined not more than $1,000, or imprisoned not more than 1 year, or both."

SEC. 8. EFFECTIVE DATE.

The amendments made by this Act shall apply to taxable years beginning after December 31, 1961.

Passed the House of Representatives June 5, 1961.

Attest:

RALPH R. ROBERTS, *Clerk.*

The CHAIRMAN, The Chair recognizes Senator Carlson for a statement.

STATEMENT OF HON. FRANK CARLSON, A U.S. SENATOR FROM THE STATE OF KANSAS

Senator CARLSON. Before you call the first witness, I would like very much to make a short statement on this bill.

I know that many millions of self-employed and their employees were pleased to learn that the Finance Committee and the distinguished chairman from Virginia, Senator Byrd, are holding hearings on H.R. 10. These fine people suffered a major disappointment in the 86th Congress when time and other factors prevented the Congress from acting on remedial legislation. In this Congress this committee spent weeks on this bill. After careful deliberation we reported H.R. 10 by a 12-to-5 vote and today we are considering a bill which is similar in most respects to last year's legislation.

I, like every Member of the 87th Congress, am concerned about the problems of the aged and aging in the United States. There are solutions to this problem, total and partial, and there are ways in which this Congress can help to alleviate the heartaches and agony that often accompany old age.

At the present time 87 percent of the working people or 58.4 million are covered by social security. The old-age and survivors insurance program is intended to provide merely the minimum benefits necessary for a subsistence standard of living. While this is encouraging, it is essential that people have other retirement programs if they hope to spend their "golden years" in an environment comparable to that of their productive years.

Now, recognizing this, the Congress in 1942 wisely enacted an amendment which gave rise to the tremendous growth of qualified private pension plans approved by the Treasury Department. Today there are approximately 30 million people covered by private and public plans—people who, thanks to the 1942 legislation, can look forward to their retirement years.

This is not true of the self-employed because they, unfortunately, but not deliberately, were omitted from the 1942 legislation and as a result for the past 19 years have been discouraged from planning for their later years. Rather than looking forward to their retirement they have a constant fear that they won't be able to work all their lives.

Now, I remember well the statement made by the spokesman for the American Farm Bureau Federation during the course of the previous hearings: The spokesman said—

> According to a survey made in 1958 by the Bank of New York among 20,000 physicians, dentists, and lawyers, 70 percent of the respondents had no planned retirement program of any kind. We are confident that a similar survey of our 1,576,642 members would disclose that an even higher percentage of farmers do not have a planned retirement program.

The enactment of H.R. 10 will serve as an inducement to the 20 million self-employed and their employees to plan for their own retirement rather than to pass on this responsibility to the Government or their children.

I thank you.

The CHAIRMAN. The Chair recognizes Senator Bennett.

STATEMENT OF HON. WALLACE F. BENNETT, A U.S. SENATOR FROM THE STATE OF UTAH

Senator BENNETT. I appreciate the courtesy extended to me in permitting me to submit this statement in regard to H.R. 10, and to my own bill, S. 474.

For the past several years, I have devoted a great deal of time and study to the subject of voluntary pension plans for self-employed individuals. As is true in the case of a number of members of the committee I followed this legislation with great interest during the period 1951–58, and then, fortunately in 1959 H.R. 10 first reached the Senate, and as a member of this committee I have studied this carefully ever since.

I am happy that S. 474, which I introduced, is identical in every respect with H.R. 10 which was passed by the House and is now before this committee.

Approximately 21 million people are now covered by private pension plans, and about a million new people are being added every year. I think this gives added reason why we should consider the problems of the self-employed and their employees, who up to this time have not had a similar opportunity.

Mr. Chairman, I have prepared a formal statement. I would like to associate myself with the statement presented to the committee by my colleague, the Senator from Kansas, and ask that the formal statement be included in the hearing record without my reading it further.

The CHAIRMAN. Without objection, the insertion will be made.

(The statement referred to is as follows:)

STATEMENT BY SENATOR WALLACE F. BENNETT ON H.R. 10 AND S. 474

Mr. Chairman, I greatly appreciate the courtesy extended to me by the committee in permitting me to submit this statement in regard to H.R. 10 and my own bill S. 474, which would permit the establishment of voluntary pension plans by the self-employed.

For the past several years I have devoted a great deal of time and study to the subject of voluntary pension plans by self-employed individuals. As is true in the case of a number of members of this committee, I followed this legislation with great interest during the period 1951–58.

Since this is a tax measure, which under the Constitution must originate in the House of Representatives, it wasn't until 1959, the year that H.R. 10 first reached the Senate, that I was finally in a position to work for elimination of this tax inequity and thereby help the millions of self-employed of this country plan for their retirement years.

During the course of the 86th Congress, along with other members of the Finance Committee, I worked diligently with officials of the Treasury Department and with representatives of the various self-employed groups in trying to arrive at a bill which would be acceptable to everyone. On June 9 of last year, after approximately 11 days of careful consideration, the Senate Finance Committee reported H.R. 10 by a 12 to 5 vote. Unfortunately, the measure died on the Senate floor in the rush to adjourn last September.

On January 17 of this year, I introduced S. 474, a bill identical in every respect to H.R. 10, which is under consideration at this time by the committee. In concept, this is not new legislation. It has been many years evolving to the present form in which this bill is drafted.

The chairman in his usual wisdom decided that in view of the fact that H.R. 10 is so similar to the bill reported by this committee last year that 1 day's hearing on this legislation would be sufficient.

This bill encourages individual initiative, self-reliance, and thrift, all qualities which are desperately needed at this time if we are to maintain our position of world supremacy. It is imperative that we continue to emphasize these qualities which of course extend far beyond the measure under discussion at this time.

In some quarters, H.R. 10 has been erroneously referred to as a "tax break" for the self-employed. This is not an accurate statement because at the present time an admitted inequity exists against the self-employed. H.R. 10, and my bill, rather than providing for a "tax break" would give the approximately 10 million self-employed tax treatment comparable to that now accorded to corporate employees.

This is a tax postponement measure and does not remove the liability from paying taxes on the income when it is finally received by the self-employed individuals. A major portion of the tax loss to the Treasury in the early years would be recouped in the later years when the individual receives his benefits.

As members of the Senate Finance Committee we should be cognizant of the fact that almost daily the Treasury Department is considering new applications from corporate groups requesting approval of retirement programs under a tax deferred status. At the present time approximately 21 million people are covered by private pension plans, and on the basis of recent figures, 1 million new people are added each year. The millions of self-employed in this country are aware of the tremendous growth of these corporate pension plans and earnestly seek to be accorded this same tax treatment.

The 1942 legislation which permitted establishment of pension plans was sound when enacted. It is still sound reasoning today, a fact attested to by the interest and participation which has occurred in these pension plans over the past 19 years.

It is my opinion, H.R. 10 is one of the most important bills in the 87th Congress, a view shared by self-employed farmers, small businessmen, and professional people throughout the country.

I recommend to my colleagues on this committee that we report this legislation so as to include the self-employed, who under the present law are prevented from adequately providing for their own retirement.

Mr. Chairman, I would like the committee records to show that I have received letters urging passage of H.R. 10 from the following groups and associations in my State:

Utah State Bar Association.
Utah State Medical Association.
Utah Veterinary Medical Association.
Utah State Dental Association.
Utah Optometric Association.
Utah State Farm Bureau.
Utah State Woolgrowers Association.
Utah State Realty Association.
Utah Cattlemen's Association.
Utah Association of Certified Public Accountants.
Utah Life Underwriters.
Utah Section American Institute of Mining, Metallurgical and Petroleum Engineers.
Utah Bankers Association.
Utah Savings & Loan League.
Utah Chapter of the American Institute of Architects.
American Dairy Association of Utah.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Chairman, I do not wish to make a statement, but I would like to have the record show that I have been authorized by Mr. Bert Overcash, of Lincoln, Nebr., one of our distinguished lawyers, that the record show that the Nebraska bar favors H.R. 10.

I have also been requested by Mr. K. B. Lucas, president of the Nebraska Society of Professional Engineers, to have the record show their endorsement of H.R. 10.

The CHAIRMAN. Thank you, Senator Curtis.

The first witness is the Honorable Stanley S. Surrey, Assistant Secretary of the Treasury.

STATEMENT OF HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY; ACCOMPANIED BY CHARLES SIMPSON, OFFICE OF CHIEF COUNSEL; AND ARTHUR FEFFERMAN, OFFICE OF TAX ANALYSIS

Mr. SURREY. Mr. Chairman, I am accompanied today on my right by Mr. Charles Simpson, of the Office of the Chief Counsel, the Internal Revenue Service; and on my left by Mr. Arthur Fefferman, of the Office of Tax Analysis of the Treasury Department.

I have a prepared statement which, with your permission, I will read, Mr. Chairman.

The Treasury Department welcomes this opportunity to present its views on H.R. 10, to encourage the establishment of voluntary pension plans by self-employed individuals.

The problem with which this bill is concerned—how to treat the retirement savings of the self-employed for tax purposes—is an important one.

The objective of H.R. 10 is to give self-employed people a tax postponement advantage for income set aside in qualified pension plans generally comparable to that now received by employees covered by such plans who are not required to include their employer's pension contributions currently in their taxable income.

Under the bill, self-employed people covered by pension plans meeting the requirements described below would be allowed income tax deductions, within certain limits, for pension contributions made on their own behalf. In general, the income set aside in such pension plans would remain free of tax until received by the individual, when it would be included in income for tax purposes. In addition, the earnings on the income so set aside would likewise be exempt from tax prior to withdrawal. Since income tends to decline in the retirement years and older people receive favored tax treatment under a number of provisions, the deferment of tax from the time when the self-employed individual makes the pension contributions until the time he receives the pension benefits would shift income to lower income tax brackets. In addition to reducing taxes, the postponement of the time when tax is payable, both as respects the amounts set aside and the earnings on such amounts, would provide substantial interest savings to covered self-employed individuals by allowing them to retain the use of funds for a longer period of time.

Under this bill—and I will now discuss the principal features of H.R. 10—self-employed people, including partners, would be allowed to be covered by qualified pension plans. Individuals would be considered self-employed for this purpose if they own more than a 10-percent interest in the business. In general, individuals who have an interest in the business which does not exceed 10 percent would be treated as employees for pension purposes.

Self-employed people with fewer than four employees would be allowed to establish pension plans for themselves without making any provision for the retirement needs of their employees. In such cases, a self-employed individual would be permitted to contribute and deduct contributions for himself up to 10 percent of his self-employment income with a maximum of $2,500 a year. Since self-employment income represents the entire net income from a trade or

business, the tax deductions of the self-employed people would be based on income attributable to capital invested in the business as well as on income from personal services.

Self-employed individuals with four or more employees would have to cover their employees under the qualified pension plan in order to secure coverage in the plan for themselves. In such cases, the pension plan would be required to cover all employees, other than part-time and seasonal employees, who have at least 3 years of service. The covered employees would have to be given nonforfeitable rights to the contributions made for them.

Where the self-employed individuals qualify as having four or more employees, the contributions on their own behalf would not be limited to the 10 percent—$2,500 allowance. In such cases, a self-employed individual would be permitted to contribute and deduct for himself any amount without limit except that the ratio of his contributions for himself to his self-employment income could not exceed the ratio of contributions to earnings of any of his covered employees. If the self-employed individuals' deductible contributions for himself did not exceed one-third of the total deductible contributions, the plan could be coordinated with the social security system by treating the employer's actual social security contributions for himself and his employees as if they were made under the private plan for purposes of determining whether the ratio test is met. Once a self-employed individual qualified as having four or more employees in any year, his deductible contributions for himself would no longer be limited to the 10 percent, $2,500 allowance, even though his employees drop below this number in any subsequent year.

Except in the event of severe disability or death, benefits for self-employed individuals would not be payable before the age of 59½ and would have to begin before the age 70½. The retirement benefits received from the plans by the self-employed individuals would be taxable as ordinary income. Averaging treatment would be accorded lump-sum distributions. In general, the tax on such distributions received after age 59½ would be equal to five times the increase in tax resulting from including in income one-fifth of the distribution. Except in case of disability, distributions of $2,500 or more to self-employed people prior to age 59½ would be taxed at not less than 110 percent of the liability resulting from spreading the distribution over the taxable year and the preceding 4 years.

Retirement funds could be invested with a bank as trustee or used to purchase retirement annuities from an insurance company or face amount certificates. Custodial accounts could also be set up with banks if the investment is solely in regulated investment company stock. In addition, the self-employed individual could purchase and distribute to his employees in the plan a special nontransferable U.S. bond redeemable after age 59½ or disability.

The bill would be effective for taxable years beginning after December 31, 1961.

PROBLEMS RAISED BY H.R. 10

The Treasury Department recognizes that the present law does not give self-employed people tax treatment for their retirement savings comparable to that now accorded to employees covered by employer-

financed pension plans. However, H.R. 10 as passed by the House does not provide a satisfactory solution.

If it is to be effective in achieving its objectives, any legislation designed to achieve comparable tax advantages for self-employed people under pension plans should at least have the following attributes:

1. It should at least grant approximately the same tax treatment under pension plans to self-employed people and corporate owner-managers. Since the principal justification for granting tax advantages for the retirement savings of the self-employed is that they are not given the pension advantages now received by corporate owners, any legislation which results in treating these groups in a markedly different fashion would merely represent a temporary expedient and not a lasting solution. Moreover, if corporate owner-managers retain important tax advantage over the self-employed individuals for pension purposes, an artificial tax incentive would remain for self-employed people to change their businesses to the corporate form wherever possible in order to secure greater pension advantages. Self-employed individuals who now cannot incorporate would also continue to seek State legislation permitting them to do so.

2. To prevent the use of pension plans to secure undue advantages, there should be at least appropriate limitations on the pension contributions made for self-employed people and corporate owner-managers. At present, despite the nondiscrimination requirements imposed by the law on qualified plans, it is difficult to check abuses which arise when owner-managers of closely held corporations establish pension plans primarily for their own benefit. In some cases, for example, the contributions under the plan may be used mainly to provide substantial benefits to the owner-managers and other employees may receive only nominal benefits or none at all. For example, a plan covering only salaried employees, which is within the purview of section 401(a)(5) of the Internal Revenue Code, could result in the coverage of the owner-managers to the exclusion of all other employees. Any legislation allowing self-employed people to be covered by qualified plans should not create problems of this type for plans covering self-employed people but instead should contain appropriate provisions eliminating these abuses where they now exist.

3. In seeking to remove discrimination against self-employed people, the legislation should not grant them coverage under pension plans under such conditions as would create a counterdiscrimination against their employees. Historically, the objective of granting favored tax treatment to qualified pension plans has been to encourage the establishment of plans to meet the retirement needs of employees. In order to achieve this objective, the Internal Revenue Code contains an entire set of provisions which were designed to confine the special tax treatment to plans which do not discriminate as to coverage or benefits in favor of owner-managers and highly paid employees as compared with the rank and file of employees. In view of this background it is especially important that any legislation in this field should require self-employed individuals securing pension coverage for themselves to provide comparable coverage for their employees without any arbitrary exclusion of certain groups of employees.

H.R. 10 does not meet these requirements. Its adoption would create new serious discriminations to replace the problems that it seeks to

solve by allowing self-employed people to be covered by qualified pension plans. It would result in very substantial differences in tax treatment for pension purposes not only for self-employed individuals as compared with owner-managers of corporations and for self-employed people as compared with their employees but also among self-employed people themselves.

In some situations, self-employed individuals would receive more favorable treatment than corporate owner-managers; in other situations, the reverse would be true. For example, where there are no employees other than the owner, corporate owner-managers would receive more favorable treatment than the self-employed. In such cases, H.R. 10 limits the amounts that a self-employed individual can contribute on his own behalf to 10 percent of his self-employment or $2,500 a year. In contrast, in accordance with the present provisions of the code, nondiscriminatory contributions to qualified pension plans on behalf of corporate owner-managers would not be subject to any specific dollar limit.

On the other hand, where there are from one to three employees, H.R. 10 would allow self-employed individuals to secure pension coverage for themselves without making any provision for the retirement needs of their employees. Under present law, the owner-manager of a corporation does not have a comparable privilege. In order to secure pension coverage for himself, the corporate owner-manager would have to establish a nondiscriminatory plan which could not automatically exclude all other employees though it could exclude employees on the basis of a nondiscriminatory classification and seasonal and part-time employees as well as those with not more than 5 years of service.

Where there are four or more employees besides the owner, both the self-employed individual and the corporate owner-manager would be required to extend coverage under the plan to their employees in order to be covered themselves. However, in such cases, there would be important differences in the qualification rules for the plans established by self-employed persons and plans established by corporations in regard to the conditions under which employees would have to be covered, the rights that employees would have to contributions made on their behalf and the method of coordinating the private pension plan with the social security system.

Besides failing to produce the same tax treatment for self-employed individuals and corporate owner-managers under pension plans, H.R. 10 discriminates against employees when it allows self-employed individuals with fewer than four employees to secure coverage in qualified plans for themselves without making any provision for the retirement needs of their employees. There is no logical basis for such an arbitrary exclusion of employees from the benefits of the pension plans covering the self-employed. Since self-employed individuals very frequently have less than four employees, the practical effect of the exclusion would be to deprive a large number of employees of the benefits of the new pension plans that would be established under the bill.

There are also not adequate safeguards to check abuses in contributions for self employed people with more than four employees. Under H.R. 10, such individuals would be permitted to make pension con-

tributions for themselves exceeding the 10 percent—$2,500 limit, presumably on the theory that they would have to grant coverage to such employees and make substantial contributions for them. However, since the contributions to the plan would be based on the self-employment income of the owner, including income from capital invested in the business, and, on the other hand, the compensation of the employees, the bulk of such contributions would be made for the owner in those cases where employees earn modest salaries and the owner's self-employment income is large. In such cases, the immediate tax reduction received by the self-employed individuals as a result of the deduction for his own contribution could greatly exceed the contribution made for his employees. Though some part of this tax reduction might be offset by the tax resulting in later years when the pension is received and included in taxable income, the net tax benefits to such a self-employed individual would generally be substantial.

Self-employed individuals, having once qualified for the larger allowances as employers of four or more individuals, can continue to contribute amounts in excess of the 10 percent—$2,500 limit in subsequent years even if they have no employees in such years. Also, because the bill specifically permits a self-employed individual to exclude from the plan employees who have less than 3 years of service and at the same time to count them in determining whether he has at least four employees, it would be possible for the self-employed individual to contribute for himself more than the basic 10 percent—$2,500 amounts without making any contributions on behalf of any other individual. As a result, some self-employed people would be able to deduct annual contributions substantially exceeding $2,500 indefinitely even though they never have any employees who qualify under the plan.

Another important defect of the present bill is that the pension contributions by the self-employed on their own behalf would be based on their self-employment income which generally includes income from capital invested in the business as well as personal service income. This would give self-employed people an important advantage over covered employees since, under present law, pension contributions for covered employees, including owner-managers of corporations, are based on earned income alone.

H.R. 10 would involve a revenue loss amounting to an estimated $358 million annually on a full-year basis. Over one-fourth of this revenue loss would be accounted for by the fact that the bill would allow self-employed people to base their allowable deductions for pension contributions on self-employment income instead of on personal service income alone. These estimates assume that actual deductions for contributions made by self-employed people on their own behalf would be only a part of the maximum allowable, ranging from 15 percent of the maximum for taxpayers with less than $3,000 of income to 66⅔ percent of the maximum for those with more than $20,000 of income. Particularly in view of the present budgetary situation, it would clearly not be appropriate to incur a revenue loss of this magnitude for legislation which would not constitute an adequate solution to the tax treatment of the retirement savings of self-employed people.

Because of these compelling considerations, the Treasury Department is opposed to the enactment of H.R. 10. Though it seeks to equalize the tax treatment of retirement savings, the bill creates many inequities and unjustifiable differences in tax treatment. As you know, the President has directed the Treasury to undertake the research and preparation of a comprehensive tax reform program to be submitted to the Congress next year. A major aspect of this program will be a broadened and more equitable tax base and reconsideration of the rate structure. We believe that the problem which H.R. 10 seeks to meet should more appropriately be considered in connection with such a general tax program so that this problem could be evaluated in the context of the entire program. At the same time this would permit consideration of the problem in the light of a general examination of issues in the pension and retirement area and in the context of the rate structure that may result from a reexamination of the existing structure. Accordingly, the Department recommends that legislation dealing with the tax treatment of the retirement savings of self-employed people be deferred until it can be considered in the perspective of the entire tax reform program.

The CHAIRMAN. Thank you, Mr. Surrey.

Would you give to the committee an analysis of the bill as passed by the Senate Finance Committee, H.R. 10, last year, as compared to the bill H.R. 10 as passed by the House of Representatives?

Mr. SURREY. I have, Mr. Chairman, arranged in tabular form, a comparison which I can hand to the committee, if that would be of any help.

(The following was later received for the record:)

Principal provisions of the versions of H.R. 10 reported last year by the Finance Committee and passed this year by the House

	Finance Committee bill (86th Cong.)	House bill (87th Cong.)
Basic concept	Self-employed persons generally are treated as employees for pension plan purposes and are eligible for coverage in qualified plans.	Self-employed persons generally are treated as employees for pension plan purposes and are eligible for coverage in qualified plans.
Coverage for employees of self-employed individuals.	In all cases, nondiscriminatory pension plans are required to be set up under the rules of present law giving employees, if any, coverage on the same basis as the self-employed individual.	Self-employed persons establishing pension plans for themselves are required to cover their employees in the plan only if they have more than 3 employees. In the latter case all full-time employees with more than 3 years of service must be covered under nondiscriminatory pension plans set up under the rules of present law with certain modifications to cover self-employed individuals.
Amount deductible annually by self-employed individuals.	10 percent of earned income or $2,500, whichever is less or an amount equal to ½ of the vested constributions made for true employees. Applicable only to more than 10 percent owners.	(a) 10 percent of self-employment earnings, or $2,500, whichever is less, in the case of self-employed individuals with 3 or fewer employees. Applicable only to more than 10 percent owners. (b) An amount proportional to contributions made for employees, in the case of self-employed persons with more than 3 employees. Applicable only to more than 10 percent owners.
Amount deductible for corporate employees who are more than 10 percent owners.	10 percent of earned income, or $2,500, whichever is less, or an amount equal to vested contributions made for other employees, or an amount sufficient to fund an annuity amounting to 20 percent of average pay.	No provision. In accordance with present law there are no specific limits on contributions for owner-employees of corporations, provided such contributions are not discriminatory.
Exclusion of certain employees	Employees with more than 3 years' service (other than part-time and seasonal employees) could not be excluded for years of service, but could be excluded because of nondiscriminatory classification. Applicable only to plans covering self-employed individuals or more than 10 percent owner-employees of corporations.	In the case of self-employed individuals with more than 3 employees, all employees with 3 years' service (other than seasonal and part-time employees) are required to be covered.
Vesting	Vesting is required in all profit sharing and stock bonus plans, and in pension plans if (a) a covered person controls (by more than 50-percent ownership interest) the trade or business, or (b) the deductible contributions for more than 10 percent owners exceed the 10 percent-$2,500 limitation.	(a) In plans covering self-employed persons with more than 3 employees, complete vesting is required. (b) In plans covering self-employed individuals with 3 or fewer employees, no provision.
Coordination with social security	Coordination permitted under rules of present law where vested contributions for employees are at least twice as great as contributions for more than 10 percent owners.	(a) Coordination permitted for plans covering self-employed persons with more than 3 employees if contributions for such self-employed persons do not exceed ⅓ of the total deductible contributions, but special rules apply. (b) In case of self-employed persons with 3 or fewer employees, no provision.
Capital gains treatment on lump-sum distributions received by self-employed people.	Special averaging provided instead of capital gains treatment	Special averaging provided instead of capital gains treatment.
Estate and gift tax exclusions	Self-employed individuals not eligible for estate and gift tax exclusions.	Self-employed individuals not eligible for estate and gift tax exclusions.
Limitation on time of payment of benefits.	Benefits could not be payable to more than 10 percent owners before age 59½ (except in the case of permanent disability or death) but must begin before age 70½.	Benefits not payable to more than 10 percent owners before age 59½ (except in the case of permanent disability or death) but must begin before age 70½.
Face amount certificates	No provision	Investment in face amount certificates permitted.
Custodial account	do	Custodial account in lieu of trust is permitted if investments are solely in regulated investment company stock.
Bond purchase plan	Permitted	Permitted.

Source: Treasury Department, Office of Tax Analysis, July 25, 1961.

The CHAIRMAN. Go through it item by item. I would like to know the difference.

Mr. SURREY. This table compares the Senate Finance Committee bill reported in the 86th Congress with H.R. 10 passed by the House this session.

The left-hand column indicates the particular topics covered, and the other two columns indicate the differences between the bills.

With respect to the basic concept, both bills put self-employed persons generally under the pension-plan system. They are treated as employees for pension-plan purposes and eligible for coverage in qualified plans.

The next topic, coverage for employees of self-employed individuals, the Finance Committee bill in all cases required that nondiscriminatory pension plans be set up under the rules of present law covering the employees of the self-employed. Under H.R. 10 self-employed persons establishing pension plans for themselves are required to cover their employees in the plan only if they have more than three employees. And in the latter case, all full-time employees with more than 3 years of service must be covered under the plan.

The CHAIRMAN. More than three full-time employees?

Mr. SURREY. More than three full-time employees.

Now looking at the amount deductible annually by self-employed individuals, under the Finance Committee bill, 10 percent of the earned income, or $2,500, whichever is less, or an amount equal to one-half of the vested contributions made for their employees.

Under the House bill, there are really two provisions. In the case of the self-employed individuals with three or fewer employees, the limit is 10 percent of self-employment income, or $2,500, whichever is less. When the self-employed has more than three employees, then the 10-percent or $2,500 limit does not apply, and the amount that can be contributed on the self-employed's behalf need only be proportional to contributions made for employees.

With respect to amounts deductible for corporate employees who are more than 10-percent owners, the so-called corporate owner-managers, the Senate Finance Committee bill contains provisions limiting the amounts which might be contributed on behalf of the corporate owner-managers to 10 percent of earnings, or $2,500, whichever is less, or an amount equal to vested contributions made to other employees.

In the House bill there are no provisions dealing with the corporate owner-manager.

Senator BENNETT. It is the amount limited to one-half of the vested contributions of corporate employees.

Mr. SURREY. With respect to corporate employees, it is a 1-for-1 ratio, Senator, I believe.

The one-half is as to self-employed persons.

As I say, with respect to the Senate Finance Committee bill, there was a provision regarding corporate owner-managers.

With respect to the House bill, there is no such provision.

As to the exclusion of certain employees, under the Senate Finance bill employees with more than 3 years service other than part-time and seasonal employees, cannot be excluded for years of service, but could be excluded because of a nondiscriminatory classification.

Under the House bill, where there are more than three employees, all employees with 3 years' service other than seasonal and part-time employees are required to be covered.

As to vesting, under the Senate Finance Committee bill vesting is required under all profit-sharing and stock-bonus plans, and also in pension plans if a person controls more than a 50-percent interest in the trade or business, or deductible contributions for more than 10-percent owners exceed the 10 percent-$2,500 limitation.

That was the vesting requirement with respect to all plans in the Senate Finance Committee bill.

Under the House bill, if the plan covers more than three employees, then complete vesting is required, but where the self-employed has three or fewer employees, there is no provision, because there is no requirement to cover it.

As to coordination with social security, under the Finance Committee bill, coordination is permitted under the rules of the present law where vested contributions for employees are at least twice as much as contributions for more than 10-percent owners.

Under the House bill, coordination is permitted with respect to social security for plans covering self-employed persons with more than three employees if the contributions for such self-employed persons do not exceed one-third of the total contributions, but different rules of coordination apply.

In the case of self-employed persons with three or fewer employees, no provision is provided in the House bill, because the employees are not required to be covered.

As to capital gains treatment on lump sum distribution received by self-employed people, both bills contain special averaging rules instead of capital gains treatment.

As to the estate and gift tax exclusions, both bills state that the self-employed individuals are not eligible at present for the estate and gift tax exclusions.

As to limitation on time of payments of benefits, the bills are pretty much the same in this respect.

As to the kinds of things in which the contributions could be invested, as to face amount certificates there was no provision in the Senate Finance bill, and the House bill permits investments in these certificates.

Similarly as to custodial account, there was no provision in the Senate Finance Committee bill, but this would be permitted under the House bill.

And as to bond purchase plans, special type of Government bonds, both bills would permit the use of such bonds.

The CHAIRMAN. Would you indicate what the difference is between the two bills, the Senate Finance Committee bill or the House bill, which are more favorable from the standpoint of the Treasury than the pending House bill?

Mr. SURREY. The directtion of the Senate Finance Committee bill on the whole is in the more favorable direction, in the sense that it requires coverage of all of the employees of the self-employed rather than setting up this division of the three, or of the four or more, as in the House bill.

Also the limitations on deductions, on the amount to be contributed by the self-employed, are more in the proper direction in the Senate bill than in the House bill.

I have in mind such matters as the fact that the Senate Finance Committee bill is based upon earned income, whereas the House bill is based upon self-employment income.

In addition, there is in the Senate Finance Committee bill a requirement that the contributions made on behalf of the self-employed must bear a certain relationship—it is really in a sense a one for two relationship—with respect to the contributions made by the employees of the self-employed, whereas in the House bill, once you get to the situation where there are four or more employees, the 10 percent–$2,500 disappears, and there is no effective limit that takes its place.

With respect to the corporate owner–managers, the House bill does not have any provision in it at all in that respect. The Senate bill does have provisions limiting the amount that could be contributed by corporate owner-managers. There is a serious question whether those limits go far enough, but at least the Senate Finance Committee bill recognizes the problem of comparisons between corporate owner-managers and the self-employed, whereas the House bill does not go into that problem.

With respect to the question of the types of employees who can be excluded once there is a pension plan, the House bill is tighter in this respect than the Senate Finance Committee bill, and once you do get to four or more employees under the House bill then they have to be covered, whereas under the Senate Finance Committee bill they can be excluded, as under present law, under a so-called nondiscriminatory classification.

Also the vesting provisions are tighter under the House bill than under the Senate Finance Committee bill, and the coordination with social security is tighter than under the Senate Finance Committee bill.

The other provisions are pretty much the same.

The CHAIRMAN. Thank you very much, Mr. Surrey.

Any questions?

Senator DOUGLAS. Mr. Surrey, in his testimony before the Treasury and Post Office Subcommittee of the Senate Appropriations Committee, as printed in the hearings on page 182, Secretary Dillon stated that in 1959 the total income not reported on tax returns was $27.9 billion. Do you remember that testimony?

Mr. SURREY. Yes. I don't have the exact figures in mind, but I remember the testimony.

Senator DOUGLAS. And deducting the $3.5 billion which is estimated income received by individuals who are not required to file returns, this leaves $24.4 billion of total taxable income not accounted for on tax returns.

Now the Secretary gave a breakdown of these figures, dividends $900 million, interest $2.8 million, and those amounts are covered in the withholding provisions of the forthcoming tax bill; annuities and pensions, $600 million.

But then there is a statement that business and farm income not reported amounted to $12 billion. One-half of the unreported income was business and farm property.

Do you remember those figures?

Mr. SURREY. Yes, sir.

Senator DOUGLAS. You are pretty certain that these figures are approximately correct?

Mr. SURREY. Those are the best figures that the Internal Revenue and Treasury Department are able to obtain in this area.

Senator DOUGLAS. We have been making certain computations to find out the probable amount of farm income.

In 1959 the total net farm income was $11.8 billion, but $3½ billion of this was the imputed value of dwellings and food on the farm, and that only $8.3 billion was cash farm income on which taxes were owed.

And if farmers evaded 25 percent of their taxes, then they would evade only a little over $2 billion.

This would leave approximately $10 billion of avoidance by the self-employed.

Is that approximately correct?

Mr. SURREY. I gather that under those assumptions it would be.

Senator DOUGLAS. In looking at the figures in the Economic Indicators, one finds that the total income of the self-employed, excluding the farmers, would be $34.7 billion, if therefore, the total evasion was approximately $10 billion of $34.7 billion, this indicates that 29 percent of business and professional proprietors' incomes were not reported or hence evaded and avoided.

Now isn't this about as large a percentage—the largest percentage of evasion and avoidance of any group in the community?

Mr. SURREY. As I recall the figures, the estimates we have with respect to noncompliance are the largest in that general area.

Senator DOUGLAS. And this bill is designed to give further tax benefits to this group which already has the highest percentage of evasion and avoidance. These further tax benefits would amount to $358 million a year?

Senator CURTIS. Would the distinguished Senator yield for a question?

Senator DOUGLAS. Surely.

Sentor CURTIS. Your reference to tax avoidance or evasion by farmers, is that a hypothetical situation, or based on Illinois farmers, or national?

Senator DOUGLAS. Well, we assume 25 percent. If you want to assume 30 percent and put them on a parity with the other self-employed, that would only make a difference of $22 million, it would come down to a 28 or 29 percent avoidance or evasion.

I don't want to anticipate the speech of the President that he is going to give tonight but I take it that it is possible that the President might ask for some tax increases.

I wouldn't ask you to express your opinion on that, but I would not be surprised if the President asked for a general tax increase. Certainly he will not call for tax decreases.

Now is it not true that the deferral of these taxes would mean a loss of interest during the number of years in which taxes are deferred?

Mr. SURREY. A loss of interest to the Government?

Senator DOUGLAS. Yes.

Mr. SURREY. Or a gain in interest to the taxpayers.

Senator DOUGLAS. And that, therefore, this is a hidden subsidy. And is it not also true, as you stated, that when the pensions are received they will be received at a time when the individuals' incomes are lower than they were at the time that taxes would otherwise have been paid, and that, therefore, this represents a further loss of revenue to the Government in contributions?

And does not this amount, therefore, become a subsidy for this class which is paid for by others?

Mr. SURREY. You are enumerating the tax advantages that exist under such pension plan treatment.

Senator DOUGLAS. Is it not true that governmental employees pay taxes under Government pension plans on the amount which the employees put into their retirement fund?

Mr. SURREY. Yes, sir.

Senator DOUGLAS. And is it not also true, that the same condition applies so far as employees of State and local governments are concerned?

Mr. SURREY. Yes, sir.

Senator DOUGLAS. Is it not true that employee contributions in corporate pension plans are taxed where the employee initially receives his income?

Mr. SURREY. Initially, that is correct.

Senator DOUGLAS. What justification is there for giving the self-employed the right to defer the taxes on the amounts which they receive?

Mr. SURREY. I gather that the justification advanced is based on a comparison of the self-employed persons in the first instance with corporate owner-managers as that class of indiivduals most comparable, I would say, to themselves.

Senator DOUGLAS. But part of their income comes from personal effort?

Mr. SURREY. In the case of the self-employed.

Senator DOUGLAS. And I gather that the proponents' argument would run that in the case of corporate owner-managers or a shareholder who is working in the business, to the extent that both of their incomes come from personal service, these classes could be accorded comparable treatment.

Mr. SURREY. And I think that is the basis of the case that is being advanced.

Senator DOUGLAS. This would give them preferential treatment as compared to governmental employees, both of the National and State and local government, is that not true?

Mr. SURREY. It is true in the sense that you regard the self-employed and the corporate owner-managers as contributing their own amounts to the pension plan.

Senator DOUGLAS. And what about those who receive social security, do they not pay income taxes on the amounts which are deducted from their salaries and wages and which go into the social security retirement plan?

Mr. SURREY. Yes; that is correct.

Senator DOUGLAS. And is this not also true of railway employees?

Mr. SURREY. That is correct.

Senator DOUGLAS. Now, may I ask this: If the principle of H.R. 10 once gets into the law, how could it be denied to equally deserving individuals, such as those on social security, railroad retirement, Federal, State, and local government employees, employee contributions to corporation pension plans, and those who do not now have these privileges?

Mr. SURREY. I think that is one of the difficulties that has beset this problem all the way.

If you look at the situation in that light, and compare the self-employed, not with the parallel that is advanced on behalf of this bill, that is, the corporate owner-manager, but if you compare the self-employed with others who are making contributions to retirement who do not receive deductions, then in that light the problem becomes exceedingly difficult, because of the revenue implications of extending a deduction to everybody who makes a contribution or saving for retirement.

Senator DOUGLAS. A similar bill to H.R. 10 for employees under railway retirement laws has, of course, been pending before Congress for a good many years?

Mr. SURREY. That is correct.

Senator DOUGLAS. Has the Department made estimates as to what the ultimate cost in revenue would be, that is the annual loss in revenue would be if this principle were universalized to cover those on social security, Federal, State, and local government employees, railroad retirement, employee contributions to corporate pension plans, and so forth?

Mr. SURREY. I have some estimates which could be presented. It would cost about $3 billion a year to allow all individuals, including self-employed and all employees, to deduct up to 10 percent of all forms of income or $2,500, whichever is the lesser.

The cost of extending such deductions to the wages of employees not covered by pension plans would be about $1.2 billion, and to extend it to employees not adequately covered by pension plans under this $2,500 limit, would raise the cost to $1.7 billion a year.

Senator DOUGLAS. The total cost would still be $3 billion?

Mr. SURREY. Yes.

If you allow deduction of present contributions to governmental pension plans, such as social security, railroad retirement, and Federal and State, and private plans, the loss would be $1.7 billion. These estimates are not additive. The overall loss might be $4 billion.

I think the overall total is about $4 billion.

Senator DOUGLAS. I wonder if you would be willing to present for the record a memorandum on this report?

Mr. SURREY. Yes.

(The table referred to follows:)

Revenue loss from allowing taxpayers to deduct 10 percent of their income, up to a maximum of $2,500 annually, for contributions to retirement plans

Retirement program:	Millions
1. Social security taxes on employees and self-employed	$1,135
2. Railroad retirement taxes on employees	55
3. Federal, State, and local retirement payroll deductions	370
4. Employee contributions to private pensions plans	165
Total revenue loss from allowing deduction of employee contributions under existing retirement programs	1,725
5. Allow employees not under a pension plan to deduct 10 percent of wages and salaries up to a maximum of $2,500	1,250
6. Allow employees under an inadequate retirement plan to deduct enough to make combined employer-employee contributions equal to 10 percent of wages and salaries up to $2,500	450
Total effect of permitting employees to use provisions of H.R. 10	1,700
7. Allow any taxpayer to deduct 10 percent of his adjusted gross income up to a maximum of $2,500	3,000

NOTE.—Under programs 1 through 4 it is assumed that all contributions not in excess of the employees' taxable income will be deducted.

Under programs 5 through 7 it is assumed that taxpayers would voluntarily contribute and deduct proportions ranging from 15 percent in the lower income classes to 66⅔ percent in higher income classes, of the amounts permitted them.

The last 3 programs are not additive to the first 4. Some persons who might otherwise elect plans 5 through 7 would find their tax liabilities eliminated by 1 of the first 4 programs. An overall limit of 10 percent up to $2,500 would reduce some contributions by the amount of their present payroll deductions.

The combined effect of programs 1 through 6 would be approximately $3 billion. The combined effect of program 7 and the first 4 programs is approximately $4 billion.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, July 31, 1961.

Senator DOUGLAS. Mr. Chairman, I suggest that we should be very careful before we open Pandora's box.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Gore?

Senator GORE. Mr. Secretary, did you testify before the Ways and Means Committee on this bill?

Mr. SURREY. There was no public hearing held on this bill, Senator Gore.

Senator GORE. Does that mean that the House Ways and Means Committee and the House passed a bill like this without a public hearing?

Mr. SURREY. Yes; there were no public hearings on the bill.

I did speak in executive session.

Senator GORE. Did you make these same points to the House committee?

Mr. SURREY. I did not state them at this length. I stated the general conclusions, that the matter should be deferred and considered in context of a general tax reform program, and I indicated the revenue loss, but I did not have the opportunity because of the time to make the statement and analysis that we are presenting today.

Senator GORE. Were you not asked for a statement?

Mr. SURREY. I am sure if we had had the information prepared in time the House committee would have heard it.

As a matter of fact, some other bills and it came up rather hurriedly.

Senator GORE. Were you not asked these questions?

Mr. SURREY. I think the committee had considered this bill in prior years, and bills of this kind, and I gather regarded themselves as familiar with the subject.

Senator GORE. I won't ask you any further about it.

Perhaps I should not have asked you anything at all about executive hearings before another committee.

I think the record on this subject has already been made in our hearings last year. I think you have given a good statement.

I note that you are not satisfied with justifying one inequity because of the existence of another inequity.

Mr. SURREY. I think there are certain difficulties in pursuing that policy.

Senator GORE. Is there any end to the difficulties?

Mr. SURREY. Not in the nature of things; no.

Senator GORE. Is it the intention of the Treasury Department in presenting the tax reform bill for next year to recommend the removal of the inequities now existing in the corporate pension plan area?

Mr. SURREY. The pension area, as I indicated in my statement, is one which we think should be be studied.

I might add that as a result of the hearings before this committee last year the Internal Revenue Service is currently making an examination of about, I think, 7,000 pension plans to obtain statistical and other data which the Department presently lacks and needs in order to consider this matter.

And the analysis of this data will be an important part of our study of the area.

Senator GORE. I would like to read to you a short excerpt from that hearing last year.

Mr. Lindsey stated as follows:

> We start out by looking at pension plans at the corporate level. And bear in mind you don't always have a corporate tax, particularly in the service area, because you can possibly sustain low salary deductions if all the income is derived from services. Add on a profit-sharing plan, and that further reduces the corporate income for tax purposes.
>
> Even if it doesn't eliminate the corporate tax altogether it might bring the 30 percent rather than 52 percent rate, which would be an advantage of itself. Some corporations can elect not to pay the corporate tax and still have pension plans.

Do you concur in that analysis of the present law as it applies to corporate pension plans?

Mr. SURREY. I gather what he is referring to there is those corporations, the so-called subchapter (S) corporations, which, being corporations, can have pension plans, the shareholders of which can elect to pick up the corporate income in their income, and consequently there would be no corporate tax.

I think that is what the latter part of the statement directs itself to.

Senator GORE. And there is no limit to the number of corporate pension plans to which an individual can accommodate himself under the present law?

Mr. SURREY. That would be correct.

Senator GORE. And is it not a fact that some fortunately situated individuals are beneficiaries of many, many corporate pension plans?

Mr. SURREY. That, Senator, I do not know first-hand. This is some of the information which we are hoping to obtain from this examination.

Senator GORE. I will ask you again, is it the intention of the Treasury Department, in recommending reform in this field, to recommend some limitations to correct existing inequities as well as to consider the possible desirability of self-employed pension plans?

Mr. SURREY. Yes, it is our intention to consider the pension plan areas to see what recommendations should be made which would be appropriate in that area.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Surrey, in your statement you mentioned that the Treasury Department recognizes that the present law does not give self-employed people tax treatment for their employees covered by employer financed pension plans.

Now, I assume, based on that statement, that you do have in mind making suggestions as to some program or some solution of this problem which evidently the Treasury recognizes as well as everyone else.

Here is a group of people that should have consideration.

What do you have in mind?

Mr. SURREY. What I had in mind was this, Senator: As I indicated to Senator Douglas, if you view this problem from the standpoint of a comparison of the self-employed persons with the corporate owner-managers, if you view it in that context—and perhaps with the corporate executive, as to whom, I gather, some of the people who advocate H.R. 10 also make a comparison—if you view it in that setting, then the corporate owner-manager has present tax advantages which the self-employed does not.

And the self-employed person sort of stands at a borderline here, it seems to me, where the question is whether you look at him as closely analogous to the corporate owner-manager, or whether you tend to look at him as analogous to people generally who would like to save for their retirement and don't get tax advantages. And just standing at that borderline, it is hard to say which way one should look at him.

I think that is the difficulty with this problem ever since it has come up.

That was the background for that particular sentence to which you refer.

Senator CARLSON. Mr. Surrey, if he is on the borderline, would you object if we moved him over under the other classification where he would be off the borderline and be in some better position than he is at the present time?

Mr. SURREY. I think that is certainly a consideration that has to be given to the problem.

And, on the other hand—and this is one reason why we think the matter deserves further study—if one views the self-employed as being analogous to those who are saving generally for their retirement, and, therefore, if giving the benefits to the self-employed would be viewed as a direct precedent for further extension, then I think there would be serious consequences from the revenue standpoint and the impact on the income tax.

Senator CARLSON. I notice in your statement, also, that you object to this bill, H.R. 10, the enactment of this because though it seeks to equalize the tax treatment of retirement savings, the bill creates many inequities and unjustifiable differences in tax treatment.

I would ask you if that is not generally true with most tax legislation that is enacted?

There are inequities in many of these bills?

Mr. SURREY. Yes. I certainly don't think in the end one can be an absolute perfectionist in this business.

On the other hand, just within its own context, I mean just looking at H.R. 10 by itself, within its own context, it has a rather large number of inconsistencies and variances in treatment as between one self-employed person and another, as between the self-employed and his employees, and between the self-employed and the owner-managers, so that the totality of the inconsistencies in H.R. 10 becomes rather large.

Senator CARLSON. I notice you state that you are coming up with, I trust, a comprehensive tax reform program next year, and the major aspect, you state, of this program will be a broadened and more equitable tax base, and a reconsideration of the rate structure.

I mention this equitable tax base.

You have been around Washington a long time, you are an outstanding tax attorney. Do you come up here with much hope that we are going to make great changes in the tax base?

Mr. SURREY. Senator, one can always be hopeful that if improvements are clearly discerned and needed, they will be made.

Senator CARLSON. Hope springs eternal.

Mr. SURREY. I think it is necessary.

Senator CARLSON. That is all.

The CHAIRMAN. Senator McCarthy?

Senator MCCARTHY. Mr. Chairman, I would suggest to the administration, when they look at this whole problem of pensions, that they consider the possibility that you can get equity by lowering the values without raising the values.

They seem to proceed in tax legislation on the theory that when you discover one inequity you extend it to everybody, and when you have universal inequity it is the same as universal justice. And I don't think they are quite the same.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Mr. Surrey, under the present law without H.R. 10, isn't it true that we can expect continuing revenue loss as more and more people in corporations qualify for pension plans?

The figures I have indicate that last year there were about a million new people brought under pension plans.

Mr. SURREY. Yes, sir.

Senator BENNETT. So we are not facing a situation where we have a static situation on corporations, and therefore we are not going to move into a new field with enactment of H.R. 10. We are facing a situation in which under existing law there will be continuing revenue loss if the present law is applied without change.

And we are now facing the question of whether this should be broadened to permit the self-employed to have the same privileges.

Isn't it true that some self-employed can adopt the corporate form, and thus provide themselves with this opportunity?

Mr. SURREY. That is correct, yes.

Senator BENNETT. And isn't it also true that other types of self-employed cannot adopt the corporate form?

Mr. SURREY. That is correct.

Senator BENNETT. I am not a lawyer, but I understand the corporate form is denied in most, if not all, States to lawyers.

Mr. SURREY. To lawyers, yes.

Senator BENNETT. And doctors, too?

Mr. SURREY. Yes.

Senator BENNETT. But there are conditions under which self-employed may not incorporate.

Doesn't the continuing existence of this discrimination tend to force more and more of those who can move into the corporate form to do so, and doesn't that tend to widen the discrimination which exists, not because of this law, but because of other laws?

Mr. SURREY. I think the difference in treatment, as you indicate, between owner-managers and the self-employed does force pressure on arrangements to incorporate or arrangements to secure changes in State laws that would permit the self-employed to shift over to a corporate owner-manager.

That is one of the problems and one of the difficulties in this particular situation.

Senator BENNETT. And aren't there circumstances in which people who have the opportunity to move into the owner-manager corporate form could actually get more tax advantage if they did that than if H.R. 10 were passed and they chose to operate under the proposals made under H.R. 10?

Mr. SURREY. I think that varies from situation to situation, and it is one of the difficulties with H.R. 10; that is, it would still produce within its provisions variances between the corporate and noncorporate form. That is one of the difficulties we find with H.R. 10, that it doesn't provide in terms of its own assumptions a solution to the difficulties that you are presenting.

Senator GORE. Will the Senator yield there?

Senator BENNETT. Yes, I will be glad to yield.

Senator GORE. In that connection, I heard the statement made by a man who is very prominent in the industrial and business and corporate world, whom I would not like to identify now, say that he knew of men who were beneficiaries of as many as 200 corporate pension plans.

So if that is possible under existing law, and we pass H.R. 10, which you described in the following language:

In such cases a self-employed individual would be permitted to contribute and deduct for himself any amount without limit except that the ratio of his contribution—

et cetera, it seems to me that, as Senator McCarthy says, we are building more mountains of privilege.

Thank you.

Senator BENNETT. I know that is the position of the Senator from Tennessee.

I would like to point out to him that a man cannot be an officer of corporations and be self-employed. And I don't think this comparison is valid in this particular situation. He can't be self-employed 200 times either.

He can only be self-employed once, and all of the income that comes to him from his employment must be taken into consideration.

Mr. GORE. The point I was trying to make, Senator, is that when we have such excessive and unbridled privileges in the corporate pension plan field under present law, if we undertake to equate the self-employed with owner-managers, then, as the Secretary has stated, we must also leave them without limits.

Senator BENNETT. I would think that we are talking to a certain extent about two different problems. And if we feel that it is necessary to correct the present law with respect to corporate pension plans, that should be done.

I have never heard any argument made for H.R. 10 on the ground that there are individuals who can get pensions under 200 separate corporations. The chief argument, and one that I think is very valid, is that if the corporate owner or officer is entitled to privileges set up by law, which law was passed specifically with respect to that form, it ought to be possible to pass a law specifically with respect to the self-employed granting them the same tax benefits.

I don't assume that the bill as it came out of the House, or my bill as it was introduced, is absolutely the last word. I think the committee can study it and make changes if such are necessary.

I was interested in Mr. Surrey's statement that the Department is going to study it and maybe come up next year with some proposals.

We have a representative from the House of Representatives here who is going to follow Mr. Surrey. It would be interesting if he would tell us how many times the House has studied this proposal and carried it through the hearing stage and made records.

I am wondering whether the Treasury can find any new data which hasn't been developed, at least in the amount and form that existed at the time the various hearings were held.

And, I, for one, hope that with the record of the House behind us and our own record in the Senate last year, the Senate committee will go to work on this proposal while it is before us rather than wait for the Treasury to discover what the House, I am sure, has already discovered, the limits of the statistics and the problems in this particular area.

That is all I have to say, Mr. Chairman.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. Mr. Surrey, in your opinion, is there any discrimination at the present time with regard to pension plans against self-employed people?

Mr. SURREY. If you view, Senator Hartke, the self-employed person, and put him alongside the corporate owner-manager, and you say these two people are very close to the same, then the corporate owner-manager can come under a pension plan and the self-employed person cannot.

Senator HARTKE. Not as I view it, but I was asking you whether you consider at the present time, is there any discrimination?

Mr. SURREY. If the matter could be so viewed, then there is a discrimination.

Senator HARTKE. What other view would you suggest that somebody else might take?

Mr. SURREY. Well, I think, as I indicated earlier, the difficulty all along is that somebody else might say, this self-employed person is to be looked at in the context of any person contributing to his retirement. In other words, he is to be looked at as a person who sets aside funds for his retirement, such as an employee saving through a Government plan, or a person saving through social security.

If you look at him in that context, then there is no present discrimination. And that is the difficulty I think in this area, as to which is the image one chooses to use.

There are certain implications when you pick an image, and that is another one of the difficulties. If you pick an image of people contributing to their own retirement, the revenue lost could be very great. If you pick the image of the corpoarte owner-manager, or, I think, perhaps, the corporate executive, which I think the profesisonal man often tends to pick as the image, then you must face the question, are the present pension plan provisions regarding corporate owner-managers, and to some extent executives, such as we would desire, because in that sense these people are saving for their own retirement.

And that is one of the dilemmas we get into in this proposition.

Senator HARTKE. And in that regard you do find that discrimination is present; is that right?

Mr. SURREY. If they are to be so viewed.

Senator HARTKE. Do you feel that the present corporate retirement pension plans are desirable or undesirable?

Mr. SURREY. I think that the general provisions—let me change that and perhaps start this way—I think in this country there is a general feeling that there should be encouragement on behalf of employers to do something for the retirement of the general average run of employees. And that policy has been with us long before the tax laws.

And that, really, was the basis for special tax treatment being given.

I think there is a corollary, that the public can have a concern, in view of the special tax treatment that is given to those plans, that the arrangements are proper, that the tax benefits are properly accorded. After all, there are many billions of dollars here involved as to which tax is being waived.

And I think this public concern is justified.

The other point I would make is that again one of the difficulties we have here that makes the problem so complex is that by and large pension plans came into being, and I think were primarily considered, in the context of a large corporation making provision for the rank and file of employees. And the corporate owner-manager is at the fringe or borderline of the whole pension area, and that is what makes another one of the difficulties in this situation.

Senator HARTKE. Do you feel that a pension plan has any particular greater merit for a large corporation than it does for a small corporation?

Mr. SURREY. I don't think it is the largeness or smallness of the corporation as such. The concept of the pension plan arose in the context of the employer, the owner of the business—the owners of the business—making provision for their employees as a group distinct from the owners of the business. And that is the way, I think, we tend to view most pension plans.

Senator HARTKE. You say these are special tax provisions.

You would not want to cast any of the Government in the position of giving greater tax benefits to larger corporations than smaller ones as distinguished from self-employed persons, would you?

Mr. SURREY. I think one would tend to avoid that, and I would say, parenthetically, that that is again one of the problems here, because if you view this in the context of small business versus large business, you tend to get into a situation where the owner-manager, if his benefits are to be limited, ends up with smaller pensions than the executives in larger businesses, which is another difficult factor.

Senator HARTKE. In the overall context of the special tax contributions, do you feel that the equities are greater than the inequities, or would you follow the line which I understand my distinguished colleague from Tennessee to say that he feels the inequities might outweigh the equities of the present tax situation?

Mr. SURREY. I think the general context of my statement is that we would like to reserve judgment on that, as we move into the general area and have the benefit of going through some of the additional data and the examination of some of these pension plans that are now underway.

Senator HARTKE. Do you feel that if this general approach of giving self-employed persons an opportunity to provide such a plan with special tax consideration, do you feel that this would be an overall inequitable situation in relation to what is considered the general concept of those ideas which were promoted for the larger corporations?

Mr. SURREY. Again, as I said, Senator, it is one that is close to the borderline.

In other words, if, having done that, it were to carry with it in its train the principle that people who save for their own retirement or contribute to it are entitled to equal treatment, then on balance one may say that, no, there has not been a basic improvement, because there would be serious problems that would have to be faced and solved so as not to be distinctly adverse to the rest of these people.

At the same time, I think that one would also have to know how the corporate owner-managers are to be treated, because in a sense they stand, as does the self-employed, at the borderline of this problem, in that they are owners and are contributing their own sums.

Senator HARTKE. I don't know where that leaves us, but I guess that is all right. But what I am trying to find out, basically, is here is some talk about revision, but at the present time there are certain tax advantages which are being extended to certain individuals or the corporate structure for pension plans, and basically, as I understood you to say, these were in the American tradition of trying to encourage people to provide for the later years of their lives, isn't that right?

Mr. SURREY. I think these are in the tradition, and this is where I think we have the difficulty here—these are in the tradition of general pension plans, of having the employer give additional compensation in the form of retirement benefits to his employees as a group, to his rank and file.

Senator HARTKE. And as a result of that, there have been at least allegations, which are probably true, that there have been certain abuses in that area, is that not true?

Mr. SURREY. Yes.

The abuses come perhaps not so much in how the rank and file are treated, but the fact that the provisions tend to give the benefits either to the executive group or to the owner-managers without adequat care as to the rank and file.

Senator HARTKE. And now we are coming over to an area where the group have been totally excluded by this bill, not from the question of the abuse or nonabuse, but they are totally excluded as a matter of law.

Mr. SURREY. That is right.

Senator HARTKE. And what this bill, then, is attempting to do is not to get to the heart of the abuse—and certainly I would want to oppose them if there are any provisions in the law which would lead to abuse—but this is attempting to bring back into the law some semblance of equity for those which at least are following in the American tradition of trying to provide something for their later years of life.

Mr. SURREY. But the difficulty, I think, as you pointed out when you use the term "the heart of the abuse" is that in this context some feel that the serious abuse, if we can use the term, can exist in the context of owner-managers and that if the image of the self-employed and the image of the corporate owner-manager be put closely together, one could say that if there are great and serious problems about the large benefits that can be given to corporate owner-managers, then at least this area has to be examined before any one else is to be brought into this particular area.

Senator HARTKE. And one of the criticisms that you make of the provisions of this legislation is that it does limit the amount which can be contributed, and it does limit the extent to which a person can provide either the 10 percent or $2,500, is that right?

Mr. SURREY. It is not a criticism in that context. I think this is an indication that where you are dealing with deferral for a person's own income and not in the context of his giving added compensation to others—which is the heart, really, of pension plans—when you are dealing with a deduction of a person's own income, the very fact that the limitations keep coming lower indicates that that is a serious problem.

And if at the same time you find that just by shifting the matter slightly those limitations no longer exist in the context of corporate owner-managers, then you have a serious difficulty.

Senator HARTKE. So you come down basically to a proposition that as far as the law is concerned and this particular legislation is concerned, that in order to—you come back to this, that as far as the discrimination is concerned, it is generally recognized that there is inequity, generally speaking, as far as self-employed persons are concerned, that there are abuses under the present corporate setup in regard to certain provisions there, generally the abuse of the amount involved, and that this law has written into it an attempt to qualify or at least to prevent this abuse, and, therefore, you are caught in one way, you want to prevent the abuse, and you want to preserve discrimination, but what you get into is, you use the abuse as an excuse to get around the proposition that discrimination shall be perpetually kept going just because someone has abused another man, even though this has written into itself a saving provision to prevent the very abuse which you use as a criticism against the plan.

Mr. SURREY. I would also like to add that internally H.R. 10 does not take care of these problems in a satisfactory fashion, because sometimes there are limits and sometimes not, which is an added difficulty in the context of this particular solution to the problems which have been discussed.

Senator HARTKE. Let me ask you, do you feel that at this time you are sufficiently acquainted with the fact to feel either that there are good expectations or reasonable expectations or no expectations of a real change in this plan even being submitted by the Treasury Department next year?

Mr. SURREY. I don't think at this time that I would be in a position to prejudge that with that degree of accuracy.

Senator HARTKE. So we are in a position, therefore, of saying that this plan is going to be studied, I mean the overall pension systems are going to be studied?

Mr. SURREY. Are going to be studied with an awareness of the difficulties that exist and the problems that we know exist in this field.

Senator HARTKE. I think that is all, Mr. Chairman.

The CHAIRMAN. Senator Long?

Senator LONG. Mr. Surrey, I have been tied up in a Foreign Relations Committee hearing up to now, and I haven't had a chance to hear your statement or the questions. But would you have any objection to working a measure out that would fit the same type treatment accorded to the great majority of citizens under social security? What I have in mind is that under social security the 50 percent that is set aside by the employer is not taxed, and that is a deductible item for the employer, and the 50 percent on the part of the employee is subject to tax.

Now, that is the most prevalent system that we have, and we vote and manage that system on behalf of the great majority of citizens.

Would you have an objection to patterning this retirement proposal after social security, whereby the person would pay tax on half of what he sets aside, and he would not pay tax on the other half?

Mr. SURREY. As I say, I don't think I am in a position now, without having concluded our study and without having reviewed—as I indicated earlier, the Internal Revenue Service is making a study of about 7,000 pension plans, as a result of the hearings last year before this committee, to get more data—without having all this, it is hard to come to a conclusion.

I would want to say, just looking at it in that context, such a proposal does still leave with it some of the difficulties which I observed earlier that beset this area, that is, the difficulties of the question of the treatment of the employees of the self-employed, and then the difficulties which I think are always present in this area, of the comparability of benefits and disadvantages as between self-employed and corporate owner-managers, which is a thing that we all know exists in this area. You then have this unsettled situation, where in some cases if you are free to go one way you end up in one situation, and if you are free to go the other way you end up in another situation. And you don't have any lasting solution.

I think the question of—if there is to be deferment for the savings of self-employed, and, of course, corporate owner-managers, the question of how you relate that to the social security principle of one-half considering them as an employee and one-half as an employer, is something that ought to be decided.

Senator LONG. I can understand that there are a lot of abuses in the corporate owner-manager program. In my judgment there is a considerable loophole that should be carefully studied and narrowed, or closed, one way or the other.

But when we vote in regard to doctors and others who are not covered by social security and who claim they are being discriminated against, I must admit that in some respects there is a discrimination.

Now, to a considerable degree those of us who sit on this committee and those who serve in the other House as representatives of the people are somewhat in the position of the self-employed: we represent the Government when we vote ourselves retirement programs; we vote that we can put up 6 percent and the Government puts up 6 percent not taxable to us at the time, but only taxable when we draw that portion of the benefits down.

I do not see how in good conscience, though I have been one of the diehard opponents of this legislation in the fashion that it was proposed, I can vote against giving a doctor the same tax consideration that I vote to give myself.

Mr. SURREY. I wasn't sure in that context——

Senator LONG. You see, I am talking about a split-the-difference proposition between what they are asking for and what I would be willing to vote for.

Mr. SURREY. I wasn't quite sure in that context, when you said persons not covered by social security and maybe that is part of the problem here—the only group not covered by social security are the doctors.

Senator LONG. Here is what is done under social security, which is the broadest program (and I think the same works under railroad retirement, although in a somewhat different form)—that the portion of the employee's salary which is put up for retirement is in effect

taxed before the contribution is made and the portion that the employer puts up is not taxed.

When a person is both the employer and the employee, it is fair to say that half of the income which could be attributable to the employer should not be taxed at that time, because every retirement program that we set up for our own employees and every retirement program that we vote for the general public maintains that principle. Doctors and certain other groups are perhaps asking too much when they ask to put themselves in the category of the owner-managers of corporations. Yet, I do think that they can come in good grace and ask to be put in as favorable a position as we have voted for ourselves when we voted to set up our own retirement, or voted to set up yours, or voted to set up social security, or railroad retirement.

It does seem to me that they could in good conscience ask that they be exempt from 50 percent of what they put up for their retirement up to, let us say, 10 percent, because the social security tax itself will be 10 percent within 10 years from today.

Mr. SURREY. I suppose, in a sense, maybe one of the difficulties is that that principle could go to anybody not covered presently by a pension plan, including employees.

Senator LONG. But here is what I have in mind. It seems to me that we should work toward uniformity, and it seems to me that at least the permission of deducting half of that up to some limit which is set aside for retirement purposes is in the direction of uniformity, and it does tend to eliminate discrimination which I must confess exists.

Do you not admit that as far as the doctor is concerned today, for example, that he is discriminated against under the law? Because he has to pay tax on all of it before it goes up, doesn't he?

Mr. SURREY. Yes. But, of course, the doctor is in a peculiar position—he is also not under social security because he asked not to be under it.

Senator LONG. He asked for it, but if he wants to pay for his own retirement, and does not want the Government in the picture. In good conscience can he not ask for the same tax treatment that he could get if he were being covered by social security?

Mr. SURREY. Except at that point he is asking the Gevernment to get into the picture by in effect permitting deductions through the tax system.

Senator LONG. No; he is just asking for the same thing that was given someone else under social security. He does not want you to handle the money, but he does want the same tax treatment that you give the other fellow when you handle his money for him. That is the point I have in mind. And I do think that if this proposal were modified to state that half of what is put aside, up to half of 10 percent, which would be 5 percent, that would be equitable. We are giving more than that to ourselves.

The Senators and Congressmen have voted for more than that for themselves. They voted for a 6-percent contribution on their part, and 6 percent on the part of the Government.

Mr. SURREY. Again, I think that one would have to consider within the context of the way you present this whether the principle should equally apply to any person not covered under a particular

plan. And once one were to say yes to that, the revenue implications are very great.

Senator LONG. But not as much as if you accepted this other proposition that you are testifying on. If you accepted this proposal before us, the revenue implications would be three or four times greater than if you accepted the principle which I am speaking to.

Mr. SURREY. I don't know about that. I would have to check that through. It is true, I think, under your suggestion the self-employed would have to contribute more to get a deduction for the one-half.

On the other hand, with respect to the more that he contributed, the earnings on that would be exempt from tax on the total amount.

So that I would have to check and see——

Senator LONG. Half of it would be taxed and half of it would not be taxed.

Mr. SURREY. But all of the earnings would be exempt from tax.

Senator LONG. No, only——

Mr. SURREY. Yes, because all the earnings—a half would be put in for which he did not get a deduction, the earnings on that one-half throughout his lifetime would be free of tax. And, therefore, I am not sure that the revenue implications are really deferred.

Senator LONG. I believe I have some estimate of it, and I would like for you to have some estimate of it, because I asked the same question of the previous administration. And I think the estimate that was submitted as a cost of following through with such a proposal would be one-quarter as much as if you followed the principle through on H.R. 10.

Incidentally, if you pursued that principle to its logical conclusion, you would require that taxes should be paid on funds which are totally deductible, because there are a lot of funds set up by corporate groups that are entirely deductible. So if you go back and pick up the revenue that was lost there for one-half of it as you set aside, a lot of what the cost of this program would be would be retained.

Mr. SURREY. Yes, that would be correct.

It is estimated that if H.R. 10, as passed by the House, were modified by providing that only 50 percent of contributions to voluntary retirement plans could be deducted, the revenue loss would be reduced to $150 million per year.

Senator CURTIS. Mr. Chairman?

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Mr. Surrey, not reflecting on anything you said but as an alumnus of the Ways and Means Committee I want to defend them. They spend long hours, they work with thoroughness, and have, I think, a justifiable pride in being the committee that is older than the Republic itself, being the first committee organized by the Continental Congress.

Now, they have held——

Mr. SURREY. I would like to join with you in that.

Senator CURTIS. They have held many public hearings on the principle involved in H.R. 10 for the last 15 years, have they not?

Mr. SURREY. I am not fully acquainted with the number of hearings which they have held, I believe they have certainly held hearings before.

Senator CURTIS. I think I was instrumental in getting the first two witnesses before that committee to propound this idea.

And it is not—I think the record should show that it is not infrequent for a committee of either House of Congress to decline public hearings on a matter that their body has passed in previous Congresses, especially recently.

Now, how many people are covered under existing corporate plans, just in round numbers?

All I want is an estimate.

Mr. SURREY. About 26 million are covered by so-called private plans, and about 6 million by Federal—I am sorry—26 million in all, 20 million covered by private plans and 6 million by Federal, State, and local plans.

Senator CURTIS. All right.

Direct your attention to the 20 million. What has been the annual increase in the number of people covered?

Mr. SURREY. About a million a year, I understand.

Senator CURTIS. Of those 20 million, what portion of them could be executives or higher paid employees where they might be drawing funds from more than 1 corporation upon which to base the pension plan?

It would be very small, would it not?

Mr. SURREY. Senator, I might say at that point—and that is one of the difficulties we have right now—if you ask us to dig any deeper, much deeper, for precise figures, I do not think you can get them.

And that is one of the reasons we hope that the present study of 7,000 plans will help us.

For example, might I just say this: I tried to get information myself on some of the questions that you are asking, the number of owner-managers, the number of pensions in high brackets as against low brackets, and other important questions—not more important, but equally as important questions.

Thus, when you use a figure of, say, 26 million people are covered, in one sense the figure is not too meaningful, because I think what we really would like to know is—and this may be a digression—of those covered, how many in the end get benefits, and what are the benefits? Because, due to the lack of vesting in these plans—and this is one thing that the Joint Economic Committee has asked us to study—the coverage figure tends to be not too meaningful, because in the end you do not know what happened. But we do not have the figures you request.

Senator CURTIS. I realize that. But of course any intensive study is obsolete by the time it is complete.

Mr. SURREY. These are pension plans in relation to returns filed in 1959 and 1960.

Senator CURTIS. And it takes 2 or 3 years to complete them. But we do know that in any industry, whether it is steel or automobiles, or coal, or anything else, the number of employees constitutes the greater number of people participating in the pension.

Mr. SURREY. Yes.

Senator CURTIS. And those great numbers could not be participating in more than one plan, could they? Because the chances are they are spending full time.

Mr. SURREY. I would think it is doubtful with respect to the run of mill employees.

Senator CURTIS. As a practical matter, the law providing for the present tax treatment of those plans will not be repealed, will it?

Mr. SURREY. You mean of pension plans generally?

Senator CURTIS. Yes.

Mr. SURREY. Yes. I would imagine that the general basic provision of deduction to the corporation——

Senator CURTIS. And tax-free treatment of the accumulation of the pension fund will not be disturbed?

Mr. SURREY. I imagine so, at least I think the case would have to be very strong to change that. I think there are perhaps some implications that follow from that existing treatment.

Senator CURTIS. Now, any modifications or amendments aimed at abuses in all probability would have to be prospective and not retroactive.

Mr. SURREY. By prospective, you mean with respect to future years?

Senator CURTIS. Yes.

Mr. SURREY. Yes; I would hope so.

Senator CURTIS. In other words, the corporate pension plan system is here to stay; that would be a reasonable assumption for Congress, would it not?

Mr. SURREY. Yes.

Senator CURTIS. Now, I listened carefully and read along the comments of the Treasury Department on the bill that passed the House this year. Could the Treasury, upon reasonable notice, prepare an amendment to deal with each one of the criticisms that they have voiced?

Mr. SURREY. I think that would be—I certainly know that we could not do as adequate a job as perhaps ought to be done in this area.

As I said, right now we feel that this matter should be considered in the context of a broader examination of the pension area which we hope to make in the light of information we are getting from these returns.

Senator CURTIS. I understand that. But you also pointed out the specifics that you thought were valid objections to the House bill. On those specifics you could prepare amendments if called upon by this committee?

Mr. SURREY. Yes. That would involve us in getting to the treatment of corporate owner-managers, and perhaps other aspects of pension plans generally.

Senator CURTIS. Now, I think we are getting carried too far afield on theory, and that the real discrimination here is a mathematical problem, the question of arithmetic. And I would like to ask the Treasury to figure out the answer to a hypothetical question I am about to state. I will try to include all the assumptions that are necessary. If I omit any, if you will advise me even at a later time, even after you have had a chance to examine the record, I will supply it.

I would like to assume—take a case of a corporate employee, and either a self-employed person or employee not covered by a corporate plan, I will assume that they are both 40 years of age. We will assume that their taxable income is $10,000 a year. This is significant to the self-employed, or to the uncovered employee, not the corporate employee.

For the same reason we will assume that each one has a wife, two children ages 10 and 12, and that at age 40 each of them sets out to provide $200 a month for his own retirement. We will assume arbitrarily that they are both going to retire at age 65. We will also assume that each of them has a life expectancy of 13 years beyond 65.

The next assumption is purely a guess, but we will assume that the pension set aside earns 4 percent. And we will disregard any growth accumulations by investing in common stocks.

But one of these individuals is going to get his $200 for 13 years under a corporate plan. The other one is going to have to save money and provide his own.

Now, under the corporate plan, that corporate earning going into that fund will not be taxed at all, will it?

Mr. SURREY. That is correct.

Senator CURTIS. Under existing law the self-employed or the uncovered employee will have to make his set-aside for this retirement after taxes, will he not?

Mr. SURREY. Yes, sir.

Senator CURTIS. Now, the interest or earnings accumulations for the self-employed or the employee that is not covered by a plan will be taxed yearly as income, will it not?

Mr. SURREY. Yes, sir.

Senator CURTIS. The interest and other earnings accumulation of the corporate plan is not taxed at all?

Mr. SURREY. That is correct.

Senator CURTIS. Now, I would like to know—and of course you will have to take the time to figure this out—how much corporate earning will be required to produce this $200 a month for the corporate employee, and how much the self-employed or the employee not under your plan will have to earn to produce a similar retirement benefit of $200 a month for 13 years after 65?

If I have left out any necessary assumption, I will provide it.

For the purposes of simplification, I am assuming a constant salary of $10,000 from age 40 to 65. I am assuming that the present tax rates will continue. Of course, that is arbitrary. There are a number of arbitrary assumptions here. But it will illustrate the problem we are dealing with.

Mr. SURREY. Yes, I will be glad to do that and make reasonable assumptions, and if I have any difficulties I will check with you on it.

Senator CURTIS. If H.R. 10 is enacted, or if a bill similar to the one approved by the Finance Committee is enacted, what group or what individuals will still be left out so far as being able to provide something for their own old age before taxes?

Mr. SURREY. I suppose one group would be those persons not presently covered by any pension plan; another group is those persons covered by pension plans where they might regard the coverage as inadequate, either because of lack of vesting, or because the benefits are inadequate. Those would be the two groups that, I think, would fit your question.

Senator CURTIS. No, I do not think it would be quite limited to that.

As a practical matter, not as a legal matter but as a practical matter, a number of people have to make their living by working for an employer, not because of lack of desire, will be unable to ever set up a pension plan, either a trusteed or insurance plan, is that not true?

Mr. SURREY. Yes.

Senator CURTIS. Is it not also true that employees and self-employed who are now old would have some very practical bars against setting up either a trusteed plan or signing an insurance contract to do the same?

Mr. SURREY. Yes.

(The following was later received for the record:)

COMPARISON OF THE COST OF A PENSION OF $200 A MONTH BEGINNING AT AGE 65 BETWEEN (A) ONE PROVIDED THROUGH A TRUST EXEMPT UNDER SECTION 401(a), INTERNAL REVENUE CODE, AND (B) ONE PROVIDED INDIVIDUALLY FROM TAXED INCOME WITH THE INTEREST ON THE ACCUMULATION SUBJECT TO TAX

Assumptions

(*a*) Full vesting in both cases in case of termination or death before age 65.

(*b*) Straight life annunity (i.e., no death benefit) after age 65.

(*c*) 4-percent interest (before tax) earned on accumulation.

(*d*) Mortality after retirement in accordance with the 1937 standard annuity table set back 1 year (which contemplates an average life expectancy for males of 15 years after age 65).

(*e*) Individual has adjusted gross income before retirement of $10,000 a year, exclusive of interest on pension accumulation, and deductions of $1,000 a year, is married, and has a total of 4 exemptions before and after retirement. Taxable income is thus $6,600, exclusive of interest on pension accumulation, before retirement, where 22 percent tax rate is effective. He is 40 years old when accumulation begins.

Example 1

Assume further that pension is tax free after retirement; i.e., individual has total income, including pension, of less than $2,675 a year after retirement.

A. Cost of exempt pension of $200 a month, beginning at age 65, can be provided by annual contributions for 25 years of $610 each.

B. Cost of pension provided by annual contributions for 25 years from taxed income is $685 a year after taxes (because of lower net interest rate (3.12 percent) earned after taxes) and $879 a year before taxes, at 22 percent rate.

(It was not clear whether it was to be assumed that the $879 was to come out of the $10,000 adjusted gross income, or whether it was to be assumed that the individual must earn that much in addition to the $10,000 to provide his pension. If the latter, it would cost a few dollars a year more, because the additional income would increase his taxable income, exclusive of interest on the pension accumulation, to about $7,480, and the interest on the pension accumulation would exceed $520 a year ending the last 10 years of the 25-year period, which would put the individual in the 26 percent tax bracket in those years. However, the additional tax involved would be only about $20 a year at the end, and the aggregate would be about $100 for the 10 years. Spread over the entire 25-year period this would involve an additional cost of about $4 a year after taxes, or $5 a year before taxes.)

Example 2

Assume each individual has sufficient other income after retirement to offset his deductions and exemptions, and has a social security benefit to use up his retirement income credit, so that the entire pension provided through the exempt trust is subject to tax at the 20-percent rate, and the portion of the individually provided pension which has not been previously taxed is subject to tax at the 20-percent rate.

A. The gross pension of $200 a month provided through the exempt trust will still cost $610 a year, as in example 1, but the net pension after taxes will be only $160 a month.

B. The pension provided by the individual from taxed income with the interest on accumulations subject to tax will be taxed under section 72(b), Internal Revenue Code, and will be subject to an exclusion ratio of about 70 percent. Thus, it would require a gross pension of only $170 a month, of which only $50 a month will be includible in income and taxed at the 20-percent rate, to yield a net pension after taxes of $160 a month.

The cost of a gross pension of $170 a month from taxed income with interest on the accumulation subject to tax at the 22-percent rate would be $583 a year after taxes and $747 a year before taxes. (The cost might be about $3 a year more if the second assumption referred to in the parenthetical note at the end of example 1B is made, for the reason stated in that note).

Summary	(a) pension provided by exempt trust	(b) pension provided from taxed income	Difference, (b) less (a)
1. If pension not subject to tax:			
Annual cost:			
After tax	$610	$685	
Before tax	610	879	$269
2. If pension is subject to tax:			
Gross monthly pension	200	170	
Net pension after tax	160	160	
Annual cost of gross pension:			
After tax	610	583	
Before tax	610	747	137

Senator CURTIS. I favored the principle of this bill. I supported the bill reported out of the Finance Committee last year. I offered an amendment that was short by a vote or two. And I expect to offer it again.

I think that the proponents of H.R. 10, or of H.R. 10 modified in any way, after reflecting upon it, should support it.

Now, the bill as drawn provides for a bond issue, a Government bond issue, to be used upon election of the parties; is that not correct?

Mr. SURREY. As I understand it, that is the case; yes.

Senator CURTIS. In substance—and I am not asking you to comment on it at this time; I merely want the record to show, and I suggest it will be very similar to what I did last year. Any individual—and I mean that individual, self-employed or employee—who in any calendar year is not covered by a corporate plan or any plan that would be set up under H.R. 10, after its enactment, be permitted to buy in limited amounts Government bonds, and do so before taxes. The bonds would mature at his retirement age; they would be nonnegotiable so he would have to play for keeps, and the tax would be applied when he cashed the bonds in later years.

Also, I think this amount should be quite modest, so that it would never be used by an employer for himself to avoid having to set up one for employees.

I think the type of people that I am speaking of, the little merchandiser who cannot set up a pension plan, the person who is making his living the hard way by working, these individuals who probably cannot save more than $25 a month anyway. I would propose that if H.R. 10 is enacted that any person in any year, where they do not have the benefits of some other plan, be permitted to buy these special bonds before taxes, and then the tax would be collected when they brought them out. It would be very simple to administer, because the individual in question could go to the post office or the bank, or

wherever they sell Government bonds, and if he wants to buy a bond that matures at $100, the seller asks his age, he looks at a table, it may cost him $85, or it may cost him $50.

Mr. Chairman, I ask that a brief analysis of what I propose be incorporated in the record at this point.

The CHAIRMAN. Without objection, it will be incorporated.

(The information referred to follows:)

SUGGESTED AMENDMENT FOR H.R. 10 BY SENATOR CARL T. CURTIS

1. Create a new series of U.S. savings bonds, possibly called X bonds (X for exempt). These bonds could have varying maturities—and would be sold at discounts based on the time until maturity. For example, a $100 maturity in 10 years could be sold for $75 similar to the present E bonds. Under this plan I do not believe the interest rate would have to be higher than the present E bonds. A $100 bond with a longer maturity would, of course, be sold for less because of the longer maturity.

2. Add an amendment to H.R. 10 that provided that anyone—self-employed or employed—could deduct from his earned income purchases of new X bonds up to a certain amount per year. The purchase price of these bonds would be free from tax, but when the bonds are cashed the entire proceeds would be taxable income and not just the interest.

3. This program could be made available for any year to any person with earned income who in that year was not covered by an employer plan of either a corporation or an individual employer. It would be very easy to administer. For example, when a person buys an X bond, he would also receive a duplicate to be filed with his tax return to support his deduction for tax purposes.

4. There would be no complication in relating the age of the individual to his bond-purchase program. For instance, the lower the age the greater the discount the individual would get on a $100 bond. An individual 55 years of age might be able to buy a $100 bond for $75. If he was 40, much less; and if he was 25, much less than that. There would be a discount table based on nearest birthday showing just what a bond would cost.

5. The bonds would be nonnegotiable, therefore, the individual would have to play for keeps. In the case of death of the purchaser, his heirs or beneficiaries could elect to hold the bonds or take their present value. The entire proceeds would be taxable.

6. The advantages of this plan are many. Among them:

(a) Equalize the system for the many fine citizens who never, never will come under a plan established by an employer.

(b) Retard inflation.

(c) Promote thrift.

(d) Place bonds in the hands of individuals.

(e) Give long-range maturity to Government bonds.

(f) Cause millions of our citizens to be interested in the fiscal stability of the Government.

(g) This plan would materially lessen the pressure for increased retirement benefits in social security and other public plans.

I believe so strongly in this that I would be willing to settle for a top annual limit of $800 earned income. This top limit could be reached in 2 years by staggering the deduction. To get the benefits of this part, the purchaser would have to certify that in no part of that year was he covered by any corporate plan or any other plan under H.R. 10.

Senator CURTIS. That is all I have.

The CHAIRMAN. Senator Anderson.

Senator ANDERSON. Mr. Surrey, is there any difference in the situation now than there was a year ago when this matter was pending before the Senate Finance Committee?

In other words, are there any financial considerations before this Government now that might not have been before us when we considered it a year ago?

Is the Government in any different financial circumstances now than it was a year ago?

I am trying to say that I understand that there are some proposals for taxes, perhaps, because of increased expenditures. I understand that the deficit for the last year ran into billions of dollars and next year it may be as much as several billion dollars.

I do not know the accuracy of these figures. Do you see any difference in the situation now than a year ago?

Mr. SURREY. Well, I suppose the situation, one could say, the situation is more unsettled now than a year ago. The very fact that we are uncertain whether or not there may be tax increases makes a difference in the situation now as compared to a year ago.

We were certainly not contemplating increases a year ago.

Senator ANDERSON. I was reading in the newspaper the other day where someone had the idea of raising the corporate tax, and lifting the personal tax a little bit. That was not in contemplation a year ago, and I am just wondering if the general tax situation is not more difficult now than it was a year ago.

Mr. SURREY. I think the considerations that you mention are relevant, but I do not want in any way to anticipate the President's statement on this tonight.

Senator ANDERSON. I do not want to anticipate it either, but if he has got some formula where we can do all the things we want to do without having a financial burden on the country, he is certainly smarter than a lot of people, me included.

I think these things cost money, and if it is going to cost $358 million, or whatever you used, one might take a different look.

Are you familiar with the professional corporations that are now being formed under the various States by doctors, lawyers, accountants, and so forth?

Mr. SURREY. Not directly.

I understand that various States are moving to enact State laws which are permitting professional people to incorporate who otherwise would not be able to do so.

Senator ANDERSON. I have business interests when I am away from here, and I subscribe to a publication that is designed to permit people to know what to do about income taxes a little bit, and lighten their tax burden. And I found this in a recent issue. It says:

> Professional corporations: The pace was stepped up this week in the parade of States which are acting to give Federal tax benefits to professional men by allowing them to practice through corporations or associations. Three new ones have joined, the new North Carolina bill, and in Illinois a similar one, and one in Connecticut—

and so forth; two bills.

If these succeed, would that not help renew some of the necessity for H.R. 10?

This allows a group of 5, 6, and up to 10 physicians to join together and associate themselves in practice, it provides that all the fees are paid in to the association, and thereby they have all the fringe benefits that go along with corporations, the right to purchase insurance, and various other things, and maybe setting up their own pension plan.

And in addition to that, they can elect that their corporation shall file as a partnership, and they proceed to report their income just as if they never joined the association.

Would that help to ameliorate some of the dangers that now appear in H.R. 10?

Mr. SURREY. I would have to study the bills in more detail. To the extent that it would be feasible for a group of people who have traditionally always operated one way to shift and operate another way, if they did so it would ameliorate the problem.

I do have to say, Senator, that while it might ameliorate one problem, in the views of some it would be increasing difficulties in another area, in a sense that again, now viewing these people as corporate owner-managers, one would have to see whether the pension rules are appropriate under those situations.

Senator ANDERSON. I think if you will study the rather rapid expansion of these bills, these doctors are not rushing in to have these bills passed, because they would rather hurt them financially.

Mr. SURREY. I did not imply that; I meant the other way around.

Senator ANDERSON. I was just wondering if there may not be things now being done that may take some of the pressure off H.R. 10. I read with great interest an issue just a few weeks ago, on July 10, which suggests if you make any business use of your home, you can set aside that as an office and charge depreciation against it. If it is a 10-room house, you take one-tenth off of all the cost of the house; if it is a 5-room house, you take one-fifth off, because you use it as an office, even though you only use it an hour in the evening, your library and den. And all of these things are constantly coming up. And I wonder if the loopholes are not becoming more perplexing to us than they have been for a long time.

Mr. SURREY. I think that is so.

I think there are some who feel that in the long run the difficulty here is really the high rates in the brackets of the professional groups generally, and if something could be done to alter those rates of taxes in some fashion, a great many of the pressures that are now felt in this particular area and similar areas would not be felt as keenly hereafter. And in the long run one can say that that is a solution that may have more wisdom.

Senator ANDERSON. I am glad to hear you say that, because I happen to be one who believes that a tax structure that runs up to 91 percent on personal income defeats its own purpose and tends to make people throw money away that they otherwise might have utilized and paid tax upon.

I hoped that we might cut the tax figure from 91 percent down to at least 70 percent. And if you constantly keep increasing the pressures we now have on expenditures, you are going to find it more and more difficult to do that, of course, because it is a popular thing to say, well, people who have large incomes are just trying to cut it down, whereas the actual fact is that a great deal of money is thrown away.

I do think it is important to realize that this might cost us what, $300 million?

Mr. SURREY. This particular bill, sir, we estimate about $358 million.

Senator ANDERSON. Would that be only the first year, or would it increase as years go by?

Mr. SURREY. It could increase if more people avail themselves of that. The revenue estimate is hard to make, because it is based on

certain assumptions as to how many people would avail themselves of these provisions. And it is hard to make a good estimate under those conditions.

Senator ANDERSON. One of the headings on this publication is good; it says: "How to save taxes by giving your family the business."

I think that is possible, but I think the problem is to keep from giving the Treasury the business.

I have nothing else.

Senator GORE. Mr. Chairman, I have another question.

Mr. Secretary, despite the many abuses in the corporate pension plan area, is it not true that the tax advantages associated with pension plans must be based upon earned income?

Mr. SURREY. Yes, sir; under the present law.

Senator GORE. Though abuses may have arisen and multiplied with the small, closely held, and owner-manager corporations, even in those the pension plan is related to the salary paid to the employee of the corporation, even though he may be the sole or substantial majority owner of the corporation stock?

Mr. SURREY. Yes.

Senator GORE. Is it not a fact, in the case of the railroad employees pension plans, that the benefits relate only to earned income?

Mr. SURREY. Yes, that is correct.

Senator GORE. Is that not true of social security?

Mr. SURREY. Yes, sir.

Senator GORE. But in H.R. 10, you tell us, it is proposed to allow pension plans based upon unearned income; is that correct?

Mr. SURREY. Yes. The definition of self-employment income in H.R. 10 is not limited to the earned-income segment of the income from business.

Senator GORE. In other words, it is income from investments, income from capital?

Mr. SURREY. Yes.

Senator GORE. Would the enactment of the bill not establish a precedent?

Mr. SURREY. Yes, that would be, I think, in that respect, an unfortunate precedent.

Senator GORE. I agree with you. It would set an unfortunate precedent, the end of which no one can foresee.

Now, we have been comparing corporate pension plans with the situation faced by the self-employed. Let's compare the self-employed person, as treated under H.R. 10, with the person who is an employee or who is self-employed but unable to earn sufficient profits to take advantage of the plan.

Does there not, then, loom a great discrimination against the employee who is unable to take a deduction?

Mr. SURREY. Yes.

As I indicated earlier, when you view the self-employed in that context, comparing him with others seeking to contribute or being unable to contribute to their own retirement, then you have discrimination between those two groups so viewed.

Senator GORE. Let us take a doctor who earns $50,000, and a person who is less fortunate financially who earns $5,000. If the cost of living for the taxpayer with an income of $5,000 a year is such that he has

nothing left to invest in a pension plan for his own personal benefit, then this bill would be of no benefit to him, would it?

Mr. SURREY. That is correct.

Senator GORE. This taxpayer would have a deduction of $600, would he not?

Mr. SURREY. Yes, sir.

Senator GORE. But to the $50,000 doctor who can invest $2,500 in a pension plan each year, for his own benefit, this bill would give a tax deduction of $3,100 a year?

Mr. SURREY. Yes, sir.

Senator GORE. Would you call that a discrimination against the $5,000 man, and in favor of the $50,000 man?

Mr. SURREY. Well, in that sense I think it would be a discrimination.

Of course, in a large sense a $50,000 person is obviously always in a more fortunate position than a $5,000 person. And viewing it in that context, you could say, just considering those two people, that the problems of the $50,000 person are not as acute as those of the $5,000 person.

Senator GORE. But this law would increase the disparity rather than, by the application of a progressive tax rate, tend to tax according to ability to pay?

Mr. SURREY. Yes, sir.

Senator GORE. In other words, one man would be given an exemption of $600; the great majority of our citizens would still be given a $600 exemption for himself and each dependent. But one who is able to make an investment for his own benefit, whether it is in proportion to his earned income or income from investment, inherited or otherwise, would be given a $3,100 exemption if he actually made such an investment.

Mr. SURREY. You are dealing in both cases with self-employed people?

Senator GORE. Yes.

Mr. SURREY. In those cases the discrimination is in the sense that both have equal advantages under the law, but both just cannot participate equally in those advantages.

Senator GORE. I have long labored under the impression that Congress should strive to enact legislation in the public interest.

H.R. 10 is special-interest legislation. I am opposed to it.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Curtis.

Senator CURTIS. Reference was made here to the fact of a report that some corporate executives were covered by a great number of pension plans.

Now, under existing law those pension plans have to be based on earned income; is that not right?

Mr. SURREY. Yes, sir.

Senator CURTIS. And is it not true that the Treasury, under existing law, has ample authority to determine whether or not the earned income of a corporate executive is reasonable?

Mr. SURREY. Yes, sir.

Senator CURTIS. They cannot pay a salary unless the service is rendered?

Mr. SURREY. That is correct.

I do not want to be put in the position of saying we can cover every single case, but the provisions of the law are the way you say.

Senator CURTIS. You cannot put a ceiling on it. But obviously no individual could render personal services to 200 corporations.

If I understood Senator Gore correctly a little while ago, he reported that information had come to him of the corporate executive participating in 200 pension plans. Would the Treasury approve tax returns that showed an individual was rendering services, personal services, to 200 corporations?

Mr. SURREY. Well, as I say, I would have to check that. Conceivably there may be situations where you have multiple corporations, in some type of activity, in which the person was a shareholder in every one of these corporations, and an executive in every one of the corporations. In those situations, what the particular benefits would come to and what would be the amount of earnings that could be considered, I just do not know whether the Internal Revenue has got any information on that or not, but I would be glad to look it up.

Senator CURTIS. Generally speaking, what tax returns are audited every year?

Mr. SURREY. I do not think I am in a position to give you the information. I do not have it at my fingertips.

It is a percentage of individual and corporate returns.

Senator CURTIS. I know, but are there not certain individuals, after the income reaches a certain amount, whose returns are audited every year because of the amount?

Mr. SURREY. Yes.

I do not think I can give you the precise information on that.

Senator CURTIS. Regardless of what the figure is, the individuals in the higher brackets do have their returns audited every year; do they not?

Mr. SURREY. It may be in certain brackets. I think there may be individuals in brackets that we might regard as high whose returns might not have a field audit every year. They might have a so-called office audit where they looked through the returns to see if there was anything wrong with the return.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Surrey.

The committee will recess until 10 a.m., Friday, July 28, 1961.

(By direction of the chairman, the following is made a part of the record:)

THE NATIONAL ASSOCIATION OF INSURANCE BROKERS, INC.,
New York, N.Y., July 26, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The National Association of Insurance Brokers includes among its membership on a countrywide basis many insurance brokers who are conducting their business on a sole proprietorship or partnership basis. These and the balance of our membership who conduct their business on a corporate basis have long felt it only proper and fair that self-employeds should receive the same tax credits related to savings and pension plans which are now available for the benefit of their employees and give to them the same benefits now enjoyed by corporate management and employees. We believe that the bill now before your committee (the Keogh bill) will accomplish this and urge that you and your associates on the Finance Committee report it out favorably at this time.

For your information, we enclose a copy of the resolution of this association which favors the principles set out in the Keogh bill and which was unanimously adopted at the annual meeting of our association last May.

Sincerely yours,

BARCLAY SHAW.

Resolved, That the directors of the National Association of Insurance Brokers, Inc., in official session at the Fairmont Hotel, San Francisco, Calif., on the 8th, 9th, 10th, and 11th of May 1961, do hereby declare themselves in favor of the principles of legislation which would extend to partners and individual proprietors the tax credits related to savings and pension plans which are now available for the benefit of their employees and would give them the same benefits now enjoyed by corporate management and employees.

PORTLAND, OREG.

Senator HARRY F. BYRD,
Chairman, Finance Committee,
Senate Office Building, Washington, DC.:

Oregon State Dental Association urges that you vote in favor of Keogh bill, H.R. 10. It would be appreciated if the contents of this wire are included in the record of the hearings on this bill.

LOUIS B. SCHOEL,
President, Oregon State Dental Association.

STATEMENT BY MOSS HART, PRESIDENT OF THE AUTHORS LEAGUE OF AMERICA, INC.

My name is Moss Hart. I am president of the Authors League of America, an organization of writers and dramatists. I submit this statement on its behalf in support of the self-employed individual's tax retirement bill of 1961. The league respectfully urges that this committee report the measure favorably to the Senate. I hereby request that this statement be included in the printed report of these hearings.

Like many other organizations speaking for self-employed craftsmen, businessmen, and professional people, the Authors League has previously had the opportunity—I might add ruefully and regretfully, several opportunities—to express its support for H.R. 10 and the retirement program for self-employed taxpayers, which it would make possible.

The Authors League has previously presented to this committee its views on why a program of tax deduction and deferment for retirement purposes is urgently needed by the independently engaged professional writer and why it is no more than fair to extend to him, and to other self-employed taxpayers, the same assistance in providing for their retirement which their counterparts in the employ of corporations have been enjoying for many, many years.

I respectfully direct the committee's attention to a copy of the statement which we presented in the summer of 1959 in support of H.R. 10. With the committee's permission, we submit herewith a copy of that statement, which is attached.

Professional writing is not the easiest or the safest way to make a living. Along with other professions, it shares one peculiar disadvantage—a vestige of the old frontier—that with each new venture, each new book or play, the author must gamble his financial resources; 1, 2, or 3 years of his life, and a considerable amount of hard work, solely on the quality of his own talents and skills, in a speculative and mercurial market. He must make this investment of money, time, and effort—on his own, without compensation from employer or support from other sources—at the great risk of enjoying, at the end of the run, an absolute financial failure; after which he picks himself up and starts all over again.

Even when the professional author has a successful novel (or play) he has precious little to put aside for a retirement fund. Whatever the Treasury allows him to keep after it has imposed high-bracket taxes on the "bunched" income from 1, 2, or more years of uncompensated labor, goes to pay off the bills accumulated while he was writing his book and to support him while he writes the next one.

Therefore, the modest amount which H.R. 10 would allow him, by way of tax deduction and deferment, for payment into a pension fund, would be even more meaningful and more useful to him (and to other risk-taking professionals) than the tax-exempt moneys paid into pension funds for employees of business corporations who have the security of continuous employment and income.

While the author has, through bitter, personal experience, learned that the Internal Revenue Code is not an instrument of logic or consistency; that it is neither consistent in its treatment of various groups, interests, and economic enterprises, nor fair in the distinctions which it makes between them—even he, cynical and resigned as he is, finds this particular discrimination between the employed and the self-employed difficult to comprehend. It is hard for him to fathom: why it is right and fair for one bloc of millions of American citizens to be assisted by tax deduction and deferment to create personal retirement funds; why it is wrong to give that same right to another group of millions of American citizens, who have the same problems, who have the same needs, who do the same work, who make the same valuable contributions to our country—and who will grow old just as certainly as will the employed taxpayers and who will need retirement security just as desperately as they will.

It is not a sufficient answer to say that tax assistance must be refused the self-employed because it would cause a loss of tax revenues. We all know that other tax benefits and advantages (given to many groups and industries for a variety of reasons) cost the Treasury as much, or more.

Moreover, the present situation is not simply a matter of the self-employed being denied a privilege which the employed now have. Self-employed taxpayers are now being required, in effect, to help finance and pay for the retirement of employed taxpayers. If the hundreds of millions of dollars which are annually paid into retirement funds for corporate employees were not tax deductible, then the Treasury would receive millions more in taxes from this source; an increase which would permit an overall reduction in tax rates, or at least, cut down further increases, thus benefiting the self-employed taxpayer.

Consistently then, Congress should do one of two things: either give self-employed taxpayers the same privilege in connection with retirement that employed taxpayers now have; or, if Congress feels that the country cannot afford equal treatment, then end the discrimination, end the tax deductibility of pension funds altogether, and let all citizens share the tax burden equitably. At least then self-employed taxpayers might have a little more left for their own pensions.

We respectfully thank the committee for permitting us to submit this statement.

CRESTVIEW, FLA., *July 24, 1961.*

Hon. GEORGE D. SMATHERS,
Senate Office Building, Washington, D.C.:

Urge support and passage of H.R. 10. This request by our bar society, first judicial circuit of Florida. Please insert in the hearing record.

Respectfully,

WM. D. FERRELL, *President.*

ROY CROSS REAL ESTATE,
Asheboro, N.C., May 9, 1961.

Senator SAMUEL ERVIN,
Senate Office Building, Washington, D.C.

DEAR SENATOR ERVIN: We at the Randolph County Board of Realtors understand that the House Ways and Means Committee has approved a tax relief for self-employed persons including professional men, farmers, and small businessmen, allowing them to defer paying income tax on as much as $2,500 a year provided this amount is put aside into a special retirement fund.

We notice that the bill is likely to pass the House, but might face uncertain fate in the Senate. We at the board would like to encourage our Senators of North Carolina to vote in favor of the bill.

Anything you can do for us as small businessmen would be appreciated very much.

Best regards from the undersigned realtors.

Sincerely yours,

Rufus Clark, president; Roy Cross, secretary and treasurer; J. B. Johns; Lorene B. Walker; John N. Bond, Jr.; E. F. Walter; Bob Morris; H. R. Trollinger, Jr.; J. L. Cobbe; Joe B. Grove; Lee M. Kearns; Claude Holt; Grier G. Newlin.

VERMONT STATE MEDICAL SOCIETY,
Rutland, Vt., June 12, 1961.

Senator WINSTON L. PROUTY,
Senate Office Building, Washington, D.C.

DEAR SENATOR PROUTY: Apparently H.R. 10, the Keogh bill, has passed the House (as it has done at least twice before) and is now in the Senate.

Not only do we hope that you will vote for it but we also earnestly hope that you will do all you can to see that it doesn't die in committee again this session as it has other years.

Respectfully yours,

GETTY PAGE.

VERMONT STATE DENTAL SOCIETY,
Rutland, Vt., June 12, 1961.

Senator WINSTON L. PROUTY,
Senate Office Building, Washington, D.C.

DEAR SENATOR PROUTY: Apparently H.R. 10, the Keogh bill, has passed the House (as it has done at least twice before) and is now in the Senate.

Not only do we hope that you will vote for it but we also earnestly hope that you will do all you can to see that it doesn't die in committee again this session as it has other years.

Respectfully yours,

GETTY PAGE.

LOS ANGELES CHAMBER OF COMMERCE,
Los Angeles, July 17, 1961.

Re H.R. 10, Keogh.

Hon. Harry Flood Byrd, Chairman and Members, Senate Finance Committee, Senate Office Building, Washington, D.C.

GENTLEMEN: We ask the privilege of placing before your committee the views of the Los Angeles Chamber of Commerce with respect to H.R. 10, Keogh, the self-employed individuals' retirement tax bill, which has been scheduled for a 1-day hearing on July 25.

Our board of directors has endorsed the principle of encouraging, through Federal legislation, the establishment of voluntary retirement plans for self-employed individuals (including retailers, other small businessmen, farmers, doctors, lawyers, and other professional individuals). As you know, corporations, large and small, are free to give "fringe" benefits including pensions to employees—from the newest apprentice to the president. At present, under an approved pension plan, an employee pays no current income tax on his company's contribution to his retirement fund, nor does the company which deducts its pension costs as business expenses. Thus, the employee accumulates a retirement fund out of pretax dollars. When the employee retires, the portion contributed by the company is subject to taxation. On the other hand, a self-employed person may now make provision for his retirement only out of after-tax dollars, usually after paying the highest tax rate experienced during his lifetime, inasmuch as a large part of such contributions to a retirement fund would normally occur during his relatively few years of peak income. This tax disadvantage is what H.R. 10 seeks to eliminate.

H.R. 10 is a modest measure, permitting the self-employed to deduct up to the lesser of $2,500 or 10 percent of self-employment earnings for amounts set aside in a retirement plan and, at the same time, requiring such individuals who employ more than three persons to set up equivalent retirement plans for their employees. It would extend to the self-employed who wish to make financial provision for retirement a tax treatment no less favorable than that enjoyed by individuals employed by others.

In our opinion, the correction of this major tax inequity is long overdue. We sincerely urge your favorable consideration of H.R. 10.

Respectfully submitted.

HAROLD W. WRIGHT, *General Manager.*

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SAN DIEGO WHOLESALE FURNITURE CLUB,
San Diego, Calif., July 17, 1961.

Re H.R. 10.
Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

SIR: The San Diego Wholesale Furniture Club, as a group of self-employed wholesale salesmen, needs H.R. 10, and we urge you to report this bill favorably to the Senate.

We shall appreciate your including our endorsement in the written record of the committee hearings.

Thank you for your kind attention.

Very truly yours,

RAY SOUTHWICK, *President.*

NATIONAL FARMERS UNION,
Washington, July 17, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Delegates to the convention of National Farmers Union, meeting in Washington, D.C., in March of this year, adopted a resolution in favor of a retirement program for self-employed persons. Their approval was expressed as follows:

"* * * Deductions for farmers and other self-employed to establish retirement funds should be permitted on the same basis currently afforded to corporations to provide such benefits for their employees."

I respectfully request your support of H.R. 10, Self-Employed Individuals Retirement Act, when it comes before the Senate Finance Committee for action.

I also respectfully request that you include this letter in the record of hearings of the Senate Finance Committee scheduled for July 25, 1961.

Sincerely,

JAMES G. PATTON, *President.*

THE DIME SAVINGS BANK OF BROOKLYN,
Brooklyn, N.Y., June 22, 1961.

Hon. KENNETH B. KEATING,
Rochester, N.Y.

DEAR SENATOR KEATING: I understand that H.R. 10, Self-Employed Individuals Tax Retirement Act of 1961 is now awaiting action by the Senate.

Although its title indicates the intention that this proposed legislation affect only self-employed individuals, section 2-(2) would, if enacted into law, disqualify, along with many others, the pension trust under which our retirement plan is funded, unless it is amended to restrict payments under an optional form of settlement to a period ending with the later of (1) the life expectancies of the retired employee and his spouse or (2) their deaths.

Our plan, which has been approved by the Treasury Department as well as the New York State Banking Department, permits the election of options which provide for the continuation of benefits for the lifetime of any beneficiary. Section 2-(2) would in most instances act to prohibit benefits from being paid to beneficiaries (other than spouses) over their lifetimes. For example, should a retired employee and his spouse live out their actuarial life expectancies and die, it would be necessary for all benefits paid with respect to such employee to cease. Should the remaining actuarial life expectancy at the death of the survivor of the employee and his spouse be 5 years, benefits to a surviving beneficiary would only be payable for such limited period instead of for the beneficiary's life. You can readily see what a hardship this would invoke.

Long experience indicates that persons other than spouses of retired employees, who frequently have no surviving spouse but have other persons dependent upon them such as minor children, retarded or handicapped relatives or dependents who have cared for their household or looked after them during illness and in old age are equitably entitled to lifetime benefits.

I am sure it is not your intention nor the intention of Congress to include in this otherwise worthwhile legislation such inhuman restrictions affecting cor-

porate and other types of pension plans under which millions of employees are presently covered. We seek your cooperation in removing these undesirable and, I am sure, unintended restrictions.

It would be preferable to delete all of section 2-(2) from H.R. 10. If this is not practicable, it would be sufficient so far as our retirement plan and the plans of most other mutual savings banks are concerned, to amend section 2-(2)(B) to read as follows:

"(B) will be distributed, commencing not later than such taxable year, during the life of such employee, or during the lives of such employee and any other person or persons."

Sincerely,

GEO. C. JOHNSON,
Chairman of the Board and President.

UNITED LIFE & ACCIDENT INSURANCE CO.,
Concord, N.H., July 11, 1961.

Re H.R. 10, Self-Employed Individuals Retirement bill.
Hon. NORRIS COTTON,
U.S. Senate, Washington, D.C.

DEAR NORRIS: The above bill which has been passed by the House of Representatives and I understand is now referred to the Senate Finance Committee, provides for the deduction of up to 10 percent or $2,500, whichever is less, of the earned income of a self-employed person which is set aside within a qualified pension plan.

We agree in principle with the purposes of this legislation. However, there are certain specific details of the current version of H.R. 10 to which we object.

The bill would make difficult the use of individual life insurance policies with a fixed premium in view of the fact that as to those persons having three or fewer employees the deduction is based upon a percentage of salary or $2,500, whichever is less, and fluctuations in income could disturb this ratio to such an extent that the plan would be disqualified, since nondeductible contributions would not be permitted.

Obviously, Congress must put some limit on the amounts to be used in this manner. However, it seems to me that the plan could be amended to make it possible for individual life insurance policies to be used by allowing more than $2,500 or 10 percent of salary to be contributed to the plan by allowing credit for only the portion permitted. In other words, I am suggesting that a limitation be put upon the amount on which income taxes can be deferred without completely disqualifying the plan if in a particular year more than the maximum amount is contributed.

There was no opportunity for a public hearing on H.R. 10 in the House; I sincerely hope that the Senate Finance Committee will hold public hearings so that the point of view I have expressed, and others, can be brought out.

Cordially,

DOUGLAS G. WHITING, *President.*

MASSACHUSETTS MUTUAL LIFE INSURANCE CO.,
Richmond, Va., July 17, 1961.

Mrs. ELIZABETH B. SPRINGER,
Chief Clerk, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MRS. SPRINGER: I appreciate the telegram of July 13 regarding the Committee on Finances hearing on the so-called Keogh bill.

My views were expressed to Senator Byrd previously that I felt that the bill, as now constituted, represented discrimination against fixed-dollar investments such as life insurance. It is easy to see that if a person were a professional man and had fluctuating income, that the amount available under the exclusions of this bill would vary from year to year.

Although it has been suggested that two contracts (one to receive the nontaxable portion and the other to receive the taxable portion of the income so allocated) might be satisfactory, it is our opinion that this will create so many complications that it will make difficult the sale of fixed-dollar equities such as annuities which are well known as excellent sources of retirement income.

I would, therefore, appreciate your expressing my views to the committee, and I believe these are the views of the National Association of Life Underwriters, that we are opposed to this section of the bill and strongly favor a revision of the bill to remove the discriminatory sections so that even if the amounts to be deposited would be varying, that one contract could be used or that perhaps an average contribution could be allowed based on past earnings.

There have been repeated warnings from members of the stock market that equities are not in any way a guaranteed repository for retirement funds of any individual. They fluctuate in price and although it is realized that there will be those who prefer to invest in this type of excludable investment, we do not believe a bill should be so worded as to deprive a man of the convenience of being able to place his money in a contract which is guaranteed to produce a definite dollar at a definite future date with no worry and uncertainty.

Please express to Senator Byrd my sincere appreciation for his thoughtfulness in wiring me with respect to this meeting, which I unfortunately will find it impossible to attend.

Sincerely,

THATCHER S. WOOD.

LAW OFFICES, WITHERSPOON & COMPTON,
Meridian, Miss., July 17, 1961.

Re H.R. 10, Self-Employed Individuals Retirement Act.

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: For years we have admired you for your drive for economy in Government. Our present indebtedness of $290 billion is appalling, especially when we consider that this is an interest-bearing debt and commitments to veterans and their dependents will cost approximately $300 billion and the liability for military and civil retirement plan is approximately $60 billion more plus $98 billion in various c.o.d.'s, or a total indebtedness of $750 billion, which is staggering and certainly mortgages America's future.

The taxes that we pay are a great burden, as you can imagine. Now, it is thought that we could have some relief by passing H.R. 10 in the 86th Congress and giving taxpayers some right to prepare for his old-age retirement. Certainly, organized labor has had benefit for such a plan for a decade and the self-employed people should not be discriminated against further in their retirement plan. We hope that your committee will give some relief to the 10 million self-employed persons and take his respite from continued spending, much of which is wasteful.

It is hoped that you will include this statement in the written report of your hearing.

With best wishes for your continued success in the Senate, I remain

Sincerely,

GIBSON B. WITHERSPOON.

AUTOMOTIVE AFFILIATED REPRESENTATIVES,
New York, N.Y., July 18, 1961.

Hon. HARRY F. BYRD,
Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We have again been advised that there will be another public hearing on H.R. 10 on Tuesday, July 25. In line with this, we, as an association of independent and self-supporting businessmen, would like to be placed on record with you as giving our full support to the reasons for having this bill passed.

Our association, while small with approximately 425 member firms of manufacturers' representatives, is made up exclusively of persons who support themselves and for whom this bill is intended.

As in the case with many independent and self-supporting businessmen, members of our association are no different. Regardless of income, the fact remains that very few of our association have ever been able to put any set amount of funds aside for their future security although, it is true, of course, that a few of our more fortunate members have taken out annuities or retire-

ment plans but the vast majority of these members have never been in a position to do so.

Our association is firmly convinced that this is a much-needed legislation which will correct an unfair situation that exists in our tax regulations. Further, it is extremely important to our members that they can plan ahead for the "golden years" of their lives without the thought of having to be solely dependent on social security or other means now provided by the Government.

Any consideration which can be given so that the H.R. 10 bill can be passed favorably will most certainly be appreciated by this organization as well as all of its members and we know that there are many others—not members of this association nor in our kind of business—who we know feel the same as we do.

Very truly yours,

ED L. LEE, *Executive Secretary.*

LANSING, MICH., *July 20, 1961.*

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.:

On behalf of the 3,600 members of the Michigan State Dental Association, I wish to express our organization's complete support for H.R. 10 as passed by the House. We believe this bill would, in addition to removing a discriminatory application of existing law, encourage savings and reduce inflationary pressures, I request that the contents of this wire be included in the record of your Senate Finance Committee hearings.

Sincerely,

FRED A. HENNY, D.D.S., *President.*

SOUTHEASTERN DISTRICT DENTAL SOCIETY,
Austin, Minn., July 19, 1961.

Hon. HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The members of the Southeastern District Dental Society, would appreciate very much your support of the Keogh bill (H.R. 10). I would appreciate your including this letter in the record of the hearings.

Yours very truly,

ROY F. RANDALL, D.D.S.,
Secretary-Treasurer.

INDIANA STATE DENTAL ASSOCIATION,
Indianapolis, Ind., July 19, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Indiana State Dental Association supports the efforts of the American Dental Association for the passage of the Keogh bill (H.R. 10) which we understand is scheduled for hearings before your Finance Committee beginning July 25, 1961. We would like for our support to be included in the record of the hearings.

We have advised Senators Hartke and Capehart that we are in favor of the Keogh bill, and we have urged them to vote for its passage in the Senate. We believe this to be a most important piece of legislation for the self-employed and the economy of the Nation. We strongly support the Keogh bill (H.R. 10).

Sincerely,

GALE E. COONS, *Executive Secretary.*

PORTLAND DISTRICT DENTAL SOCIETY,
Portland, Oreg., July 28, 1961.

Senator MAURINE B. NEUBERGER,
Senate Office Building,
Washington, D.C.

DEAR SENATOR NEUBERGER: The Portland District Dental Society is in favor of the Keogh bill (H.R. 10) and urges that you vote in favor of this bill. This necessary legislation would remove the discriminatory features of the present

law and allow the dental profession to defer income taxes so that a personal fund could be set up for the dentists' retirement.

We hope that the contents of this letter will be included in the record of the hearings on H.R. 10.

Yours very truly,

VERNON R. MANNY, D.M.D.,
Secretary-Treasurer.

ENID, OKLA., *July 21, 1961.*

Hon. ROBERT KERR,
Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR: The Garfield County Bar, Enid, Okla., urges your vigorous support of H.R. 10; request making this telegram a part of the committee hearing.

H. L. GASAWAY, *President.*

CINCINNATI, OHIO, *July 21, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington D.C.:

One hundred members of the Cincinnati Wholesale Home Furnishing Association urge that your committee report H.R. 10 favorably to the Senate and that our endorsement be included in the written record of the committee hearings.

JOHN J. CALVIN, *President.*

CAMBRIDGE, MASS., *July 20, 1961.*

Senator HARRY F. BYRD,
Senate Finance Committee,
Washington, D.C.:

The Middlesex District Dental Society, a component of the Massachusetts Dental Society, is strongly in favor of the passage of the Keogh bill (H.R. 10); request that this be included in the record of the hearing.

Sincerely,

J. RICHARD MYLES, D.M.D., *Secretary.*

WORCESTER, MASS., *July 21, 1961.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.:

This association representing over 44,000 small businessmen who sell legal beverages for off-premise consumption respectfully urges that your committee report favorably on the self-employed persons pension bill H.R. 10, as a means of equalizing their rights with those of persons employed by others; it would be appreciated if this request would be recorded at the hearings on the bill before your committee July 25.

BEN JOSEPHS,
Executive Director, National Liquor Stores Association.

FURNITURE TRAVELERS' CLUB,
Kansas City, Mo., July 19, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I am writing to you at the request of our 280 members on behalf of H.R. 10. Our organization is comprised of self-employed wholesale furniture salesmen. We work as furniture factory representatives on a sales commission only. We have none of the benefits of a company employee, such as insurance, retirement benefits, or other such fringes, since we are not an employee of the company. Men in our position find a real need for such consideration as H.R. 10 would afford us. Without such a law most of us will have to continue traveling and selling with no hope of retirement or adequate old-age security.

For the above reasons we, of the Kansas City Furniture Travelers' Club, ardently urge your committee to report favorably on H.R. 10 to the Senate. We further humbly request that our endorsement be included in the written record of the committee hearings.

We thank you for your cooperation and consideration of our request.

Very respectfully yours,

E. T. DETMAR, *President.*

CUSHING & NEVELL,
New York, N.Y., July 20, 1961.

Re H.R. 10 Self-Employed Individuals Retirement Act.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: This legislation was first introduced in 1951 and has received intensive study. It has been reported favorably by the House Ways and Means Committee and twice has passed, almost unanimously, by the House. Last year the Senate Finance Committee, after concentrated hearings, reported the bill favorably by a 12-to-5 vote, which emphasizes the bipartisan support the bill has received since its introduction 10 years ago.

The members of the American Society of Industrial Designers are anxiously awaiting the Senate Finance Committee's scheduled hearing on July 25. For 10 years the members of our society have supported the passing of this legislation, and we earnestly hope that every member of the Finance Committee will give his support to this long-overdue correction in the law relating to qualified pension, annuity, and profit-sharing plans.

We would appreciate having this statement of our views included in the written report of the hearings.

Sincerely,

GEORGE CUSHING,
Chairman, Pensions and Insurance Committee, American Society of Industrial Designers.

LANSING, MICH., *July 21, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee, New Senate Office Building, Washington, D.C.:

The board of commissioners of the State bar of Michigan favors passage of H.R. 10 and urges favorable action by the Senate Finance Committee. It would be appreciated if this telegram were made part of the hearing record.

ERNEST C. WUNSCH,
President, State Bar of Michigan.

AMERICAN PATENT LAW ASSOCIATION,
Washington, D.C., July 19, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR: It is with satisfaction that we learn that you have scheduled hearings on H.R. 10, the Self-Employed Individuals Retirement Act. Our association approves and urges the passage of this long-needed legislation which will afford similar advantages to the self-employed as are now available to the company employed.

Recognizing that the hearings are scheduled for 1 day only, we will not ask for an opportunity to have a witness testify but will request that our approval of this legislation be noted in the written record of the hearings.

With all good wishes.

Sincerely yours,

ROBERTS B. LARSON, *President.*

DEPOSIT GUARANTY BANK & TRUST CO.,
Jackson, Miss., July 20, 1961.

Re Self-Employed Individuals Retirement Act, H.R. 10.

Hon. HARRY BYRD,
Chairman of Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The board of directors of this bank has approved on the 18th day of July, 1961, a resolution expressing its support in favor of H.R. 10. Attached to the resolution is statement of the bank as to its views on this legislation and we respectfully request that this statement be included in the written report of the hearing which the Committee on Finance will hold on H.R. 10 on July 25.

Very truly yours,

N. S. ROGERS, *President.*

STATEMENT OF DEPOSIT GUARANTY BANK & TRUST CO.

This statement is being submitted on behalf of Deposit Guaranty Bank & Trust Co. of Jackson, Miss.

The officers and directors of this bank are in favor of the passage of H.R. 10, the Self-Employed Individuals Retirement Act, at this session of Congress. We feel that this legislation is sound and would have a beneficial interest on our economy. We support this measure, because it encourages savings and thrift, and rewards individual enterprise. We believe that the inequity now present in the tax laws, which do not permit self-employed persons to establish retirement plans with the same tax advantages as are possessed by corporate employees, discourages individuals who might start their own businesses if they were eligible to set up their own voluntary retirement plans and encourages them to seek employment by some corporation. We believe the encouragement of our free enterprise system will be a healthy stimulus to the long-run growth of our economy. With the modifications of the bill as now before the Finance Committee, we are advised there will be little loss of tax revenues.

As to those self-employed citizens in the professional fields, such as doctors, dentists, lawyers, and others who cannot practice under most State laws in the true corporate form, there has been a great deal of activity by the legislatures of many States (for example, Arkansas, Florida, Georgia, Minnesota, South Dakota, and Tennessee) to reach a backhanded solution to this problem by authorizing so-called professional associations, in the attempt to enable certain classes of professional men in those States to be eligible, under the "Kintner" regulations adopted by the Internal Revenue Service, for the tax treatment afforded corporate employees. We believe that H.R. 10 offers the most straightforward solution to this problem rather than setting up so-called professional associations by various States, which will be the natural result if this inequity persists in our tax laws.

We have seen a similar situation when the various noncommunity property States (such as Michigan, Nebraska, Pennsylvania, among other) began adopting community property laws in order to take advantage of the income-splitting provisions applicable to married residents in community property States prior to the time when the splitting provisions were made applicable to all citizens.

In the interest of equal treatment for similarly situated self-employed taxpayers in all States, we believe that H.R. 10 is the solution.

Our self-employed farmers and business and professional people should no longer be denied the opportunity to defer taxes on their retirement savings and to make provision for their retirement on the same basis as corporation employees. We urge the removal of this inequity which has existed since 1942, and urge favorable consideration of H.R. 10.

RESOLUTION OF BOARD OF DIRECTORS OF DEPOSIT GUARANTY BANK & TRUST CO., ADOPTED ON JULY 18, 1961

Whereas it is the view of this bank that the enactment into law of H.R. 10, the Self-Employed Individuals Retirement Act, is essential to eliminate a long-standing inequity, and to permit self-employed individuals to establish retirement plans with the same tax advantages as now possessed by corporate employees; and

Whereas the statement attached hereto more fully sets out the views of the bank on this legislation: Now, therefore, be it

Resolved, That the bank does hereby adopt the statement of views attached to this resolution and urges the passage of this legislation at this session of Congress, and that a copy of this resolution and statement of views be sent to the Honorable James O. Eastland and the Honorable John C. Stennis.

CERTIFICATE

I, Warnie C. Kennington, secretary of Deposit Guaranty Bank & Trust Co., do hereby certify that the above resolution was unanimously passed by the Board of Directors of Deposit Guaranty Bank & Trust Co. at a regular meeting of the board of directors of the bank on the 18th day of July 1961, at Jackson, Miss.

Given under my hand and official seal, this the 18th day of July 1961.

WARNIE C. KENNINGTON, *Secretary*.

DOLLOFF & RANGER,
ATTORNEYS-AT-LAW,
Brunswick, Maine, July 20, 1961.

Re H.R. 10.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: As chairman of the Maine Committee on Legislation of the Junior Bar Conference of the American Bar Associaion, I urge your support of H.R. 10, the Keogh Act, which provides tax relief for self-employed persons to enable them to accumulate tax-free retirement benefits. On June 1, 1961, John P. Carey, Esq., president of the Maine Bar Association, addressed the following letter to the Honorable Stanley Tupper, Congressional Representative from the Second District of Maine. "The Maine Bar Association would appreciate your support of H.R. 10, the Keogh Act, which provides tax relief for self-employed persons to enable them to accumulate tax-free retirement benefits."

On June 5, 1961, the House of Representatives passed H.R. 10 by voice vote which was practically unanimous. It is sincerely hoped that the Senate will follow the good example set by the House, and do the same.

This legislation is supported by organizations all over the United States, not the least of which is the American Bar Association. With the increase in fringe benefits for persons employed by private business, it seems only fair that those persons who are self-employed should be given an opportunity to put somethink away for themselves in their old age, instead of having to call upon the State, or the Federal Government, for assistance.

I respectfully request that this statement of the Maine Committee on Legislation of the Junior Bar Conference of the American Bar Association be included in the written report of the hearing to be held on Tuesday, July 25, 1961.

Very truly yours,

ORVILLE T. RANGER.

COLUMBUS, GA., *July 20, 1961.*

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Keogh bill (H.R. 10) has been unanimously approved by the Western District Dental Society of Georgia. We earnestly enlist your support and request that this letter be included in the records of the hearings.

Sincerely,

JOE M. BINNS, *Secretary and Treasurer.*

EAST COAST DISTRICT DENTAL SOCIETY,
Miami, Fla., July 21, 1961.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: On behalf of the 725 members of the East Coast District Dental Society, I wish to express our deep and continued interest in the passage of the Keogh bill (H.R. 10).

We feel the passage of this bill is extremely important to the future security of self-employed people; in addition the added encouragement of saving would help reduce inflationary trends.

Your support of the Keogh bill (H.R. 10) is respectfully requested; and we ask that this communication be made a part of the records of the Senate Finance Committee hearings.

Very truly yours,

GEORGE J. COLEMAN, D.D.S., *President.*

ROCK ISLAND DISTRICT DENTAL SOCIETY,
Rock Island, Ill., July 21, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Rock Island District Dental Society, consisting of 72 members, desires to go on record as being in favor of the Keogh bill (H.R. 10).

May this society's resolution in favor of (H.R. 10) be included in the record of the hearings.

Very truly yours,

DR. J. S. MYERS, *Secretary.*

NORTH CAROLINA DENTAL SOCIETY,
Raleigh, N.C., July 21, 1961.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: The North Carolina Dental Society notes with interest that the Keogh bill (H.R. 10) has been approved by the House Ways and Means Committee and the House of Representatives and hearings on the legislation before the Senate Finance Committee are scheduled to begin on July 25.

The society, representing over 1,100 dentists in North Carolina, is very much in favor of this bill. Not only would it benefit dentists and members of the other health disciplines, but farmers, small businessmen, and other self-employed people as well. It would permit them to defer income taxes on limited amounts set aside for retirement purposes a privilege now available to employees in industry and thereby remove a discriminating feature of the present law. More important, it would also encourage savings and reduce inflationary pressures and bolster the national economy.

We respectfully request that this communication be included in the record of the hearings.

Sincerely yours,

S. BYRON TOWLER, D.D.S.,
Secretary-Treasurer.

AMERICAN VETERINARY MEDICAL ASSOCIATION,
Chicago, Ill., July 21, 1961.

Re Self-Employed Individuals' Retirement Act, H.R. 10, 87th Congress.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Building, Washington, D.C.

DEAR MR. CHAIRMAN: It is our understanding that hearings will be held by your committee on H.R. 10 on July 25, 1961. In lieu of presenting our views through testimony during the hearings, we wish to present for your consideration this statement with the request that it be incorporated in the record of the hearings.

The American Veterinary Medical Association strongly supports H.R. 10, a bill designed to encourage the establishment of voluntary pensions plans by individuals. Our association has, for many years, endorsed the principle of legislation of this type and has worked closely with other national organizations of self-employed taxpayers in an effort to accomplish its enactment.

A problem common to numerous individuals is to provide a source of income for themselves and their families in later years related to the standard of living established during the more productive years. A solution, though difficult under the present high tax rate and inflated costs, would be in the interest of the self-employed person and the national economy. The Congress has recognized the objective as merited by amendments to the Internal Revenue Code which provides for qualified pension plans for corporate employees, including the executives. Employees participating in these approved plans do not, under the law, have to include the employer's contribution as gross income until pensions are received, and contributions by the company are deductible in the year made.

Why this tax relief to one group in our economy—the corporate employee? Why are those engaged in the private practice of their profession—the self-employed, denied by law the tax relief offered to corporations and their employees? It is an existing discrimination which we think is unfair and unsound. The American Veterinary Medical Association believes the practicing veterinarian and other self-employed persons should be encouraged and assisted to provide their own funds for their old age and retirement, by enactment of H.R. 10.

THE SELF-EMPLOYED VETERINARIAN, ECONOMIC DIFFICULTIES AND PRODUCTIVE YEARS

First, the veterinarian starts his professional career following 6 to 8 years in preprofessional and professional study. He is almost 26 years of age when entering practice, and starts to earn income. In addition, he has the initial expenses of instruments, drugs, office and other equipment. The total amount invested places a considerable financial burden on him during his first years of practice.

With this investment paid, he probably enters the period of top earning power, which is a relatively few years of high income productivity—35 to 50. During that period his financial responsibilities in educating and raising a family are increased, in addition to those in conductng his practce. As he passes the peak of his earning power, approximately 50 years of age, his income diminishes considerably. This is particularly true of those engaged in the general practice of veterinary medicine. The average net income of the veterinarian in private practice is approximately $11,000 a year before taxes.

Considering all these factors, both professional and individual, the self-employed veterinarian has little opportunity under the present law to take advantage of the more prosperous years of his practice to provide economic security for his family and himself by embarking on a sound retirement program.

These comments indicate very briefly the viewpoint of the American Veterinary Medical Association regarding H.R. 10. Our association is glad to join the other national organizations of the self-employed in urging that your committee act favorably on this bill.

We appreciate the privilege of presenting our views to your committee on this subject.

Sincerely,

H. E. KINGMAN, Jr., D.V.M.,
Executive Secretary.

THE NEW ORLEANS DENTAL ASSOCIATION,
Metairie, La., July 21, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The New Orleans Dental Association desires to let it be publicly known that it is strongly in favor of the Keogh bill (H.R. 10) and requests that this endorsement be included in the record of the hearings on this bill before the Senate Finance Committee.

We feel that the privilege of deferring income taxes on limited amounts of money set aside for retirement purposes is one that should be granted to all self-employed persons as well as to employees of industry. We feel further that this bill would tend to encourage savings and reduce inflationary pressures that are imperiling the future of our great country.

We pray that action of the Senate in this matter will result in much needed and long overdue legislative change in this matter.

Respectfully,

FRANK L. HEBERT, D.D.S., *Secretary.*

SPRINGFIELD, OHIO, *July 22, 1961.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
U. S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The members of the Mad River Valley Dental Society of Ohio are strongly in favor of the Keogh bill (H.R. 10) and ask that you and your committee act favorable upon it. Please include this in the record of the hearings.

Respectfully,

GEORGE L. SMITH, D.D.S.,
Secretary, Mad River Valley Dental Society.

MEDICAL ASSOCIATES,
Menasha, Wis., July 21, 1961.

Senator HARRY F. BYRD,
Senate Building, Washington, D.C.

DEAR SENATOR BYRD: On May 25, 1961, the Winnebago County Dental Society passed the following resolution:

"*Be it resolved,* That we, the members of the Winnebago County Dental Society, do unanimously approve of the Keogh bill (H.R. 10) in its presently written form and thereby ask its passage."

The Winnebago County Dental Society is composed of 76 members. We request that this letter be included in a record of the hearings.

Sincerely,

DR. R. A. JUNEAU,
Secretary-Treasurer, Winnebago County Dental Society.

WACHUSETT DISTRICT DENTAL SOCIETY,
Wachusett, Mass., July 21, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: As Secretary of the Wachusett section of the Massachusetts Dental Society, I have been requested, by the members of my society, to encourage support of the Keogh bill (H.R. 10).

They also feel that their above endorsement of H.R. 10 should be included in the record of the hearings.

Sincerely,

RODERICK W. LEWIN, D.M.D., *Secretary.*

NATIONAL WHOLESALE FURNITURE SALESMEN'S ASSOCIATION,
Chicago, Ill., July 18, 1961.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SIR: The National Wholesale Furniture Salesmen's Association appreciates this opportunity to submit a statement in support of H.R. 10, the Self-Employed Individuals Tax Retirement Act of 1961.

Our office is located in Chicago, Ill., which is centrally located because our members travel the width and breadth of the country. Our membership, as of June 15, was 6,166 salesmen, 64.8 percent of whom had an average income in 1960 of less than $15,000, which after deducting normal business and travel expenses (which as manufacturer's agents for the most part they must pay themselves), I am certain that you will agree does not place them in the upper income brackets.

With an income like this our members would not be able to put aside large amounts. They would be inclined, however, to develop the habit of thrift and a serious interest in planning for their retirement years. We should keep in mind that these men as a result of ambition, future experience, etc., should eventually improve on their income and having been able to develop the thrift habit they could be in a position to allocate a larger sum toward retirement pro-

grams—which will make it possible for them to rely on their savings rather than the Government in their later years.

Our association has been earnestly looking forward to the passage of this legislation for a number of years. It has been discouraging to us and I am certain to many other self-employed who realize that they are not receiving tax treatment comparable to that given corporation employees.

I hope that the members of this committee will consider the effect on the morale of the self-employed who comprise a very important part of this country's citizenry. It is our feeling that passage of H.R. 10 will show an act of faith on the part of Members of the Congress in the well-being of their constituents who are self-employed and an integral part of the backbone of America.

We would appreciate your making this endorsement of H.R. 10, on the part of our association and its membership, a part of the written record of the committee.

Respectfully,

CLARENCE V. CALDWELL, *President.*

KANSAS CITY, MO., *July 21, 1961.*

Hon. HARRY F. BYRD,
Chairman of the Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Lawyers Association of Kansas City urges support for H.R. 10 and we request that this expression of support be made a part of and be included in the hearing record of the Senate Finance Committee, which hearing is presently scheduled to be heard on Tuesday, July 25, 1961.

Very truly yours,

THE LAWYERS ASSOCIATION OF KANSAS CITY,
By DAVID SKEER, *President.*

PHILADELPHIA COUNTY DENTAL SOCIETY,
Philadelphia, Pa., July 20, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The membership of the Philadelphia County Dental Society is vitally concerned with the approval and passage of bill, H.R. 10.

We feel that, with the increasing availability of tax-free provisions for retirement purposes to people in commerce and industry, professional and other self-employed persons are victims of discriminatory taxes.

We ask that your committee approve the bill, and that this letter be made a part of the record of the hearings.

Yours very truly,

MAX KOHN, *Executive Secretary.*

MISSISSIPPI STATE MEDICAL ASSOCIATION,
Jackson, Miss., July 19, 1961.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is a formal expression of the views of the Mississippi State Medical Association with respect to H.R. 10, Keogh-type legislation providing for voluntary retirement programs for the self-employed, which we understand is before your committee for formal hearings on July 25, 1961. It is respectfully requested that this statement be considered by your committee and included in the printed record of the hearings.

Since this bipartisan legislative proposal was first introduced in the House of Representatives in 1952, our association has vigorously supported it. The fundamental basis for our position is one of correcting, even to the limited extent of the present proposal, the serious tax inequities foreclosing the possibility of the self-employed creating their own voluntary retirement funds as opposed to those who may do so under the provisions of sections 401–404, In-

ternal Revenue Code of 1954. This position has been reaffirmed on many occasions by our board of trustees, the executive governing body of the association, and our house of delegates, the representative policymaking body. In this particular connection, the Honorable David A. Lindsay, former Assistant Secretary of the Treasury, stated on June 17, 1959:

"The Treasury recognizes that present law does not give self-employed persons tax treatment for their retirement savings comparable to that now accorded to employees covered by employer-financed pension plans."

The Honorable Eugene J. Keogh stated in 1956 that "* * * I feel compelled to stress and place special emphasis on the fact that retirement and survivorship security under the old-age and survivors insurance title of the Social Security Act is an entirely separate consideration from retirement and survivorship security under the Jenkins-Keogh proposal." Mr. Keogh made a clear distinction of the separate purposes of these programs, pointing out that the proposed legislation is intended to assist persons in retirement by helping them to attain a standard of living approximating that which they enjoyed during productive years of life. This is the basis for our contention that there is no conflict between the OASDI aspect of the social security program under title II and Keogh-type legislation. The proposal before your committee should become a powerful force in obviating any necessity for committing public funds to formerly self-employed individuals in retirement by providing an incentive for individual thrift and self-preparation for the senior years.

We recognize and appreciate that your committee must evaluate the merits of the bill, the benefits serving the public interest which its enactment will provide, and any disadvantages to the economy which may result from its implementation. In these connections, we believe that—

1. *Keogh-type legislation is anti-inflationary, conducive to personal industry and thrift, and a source of capital funds important to our expanding economy.*—A tax reduction across the board obviously places additional money in the hands of the work force, tending to create new sources of consumer expenditures with inflationary tendencies. A tax-deferment program containing Keogh-type restrictions diverts such moneys away from consumer spending into controlled investment channels. New sources of capital funds are created with distinctly anti-inflationary characteristics. Participants are furnished sufficient incentives to assure completion of this cycle. After enactment of similar legislation in the United Kingdom of Great Britain, Sir Harold Macmillan, then Chancellor of the Exchequer, stated that "* * * as I expect it (the new law) to lead to a large amount of new savings, the effect on the economy should be the reverse of inflationary."

2. *Keogh-type legislation is not class legislation.*—During a decade of debate over this proposal, the charge of "class" legislation has become a familiar one. This is extremely unfortunate because it conceals the true objective of seeking to correct a patent inequity. It has been erroneously stated that the bill would benefit those in comfortable income brackets. The true and proper comparison is the successful self-employed with the successful corporate employed. Any possible advantage beyond partial correction of this tax inequity seems foreclosed by the progressive Federal income tax structure. Further, existing law provides a climate of advantage to employee groups in bargaining both for new and extended pension programs, many at the expense of employers, which enjoy tax advantages now denied the self-employed. Finally, the annual and lifetime conservation maximums appear to preclude any conceivable conservation excesses on the part of the self-employed.

3. *Keogh-type legislation will not result in enormous Treasury revenue losses.*—At the outset, we emphasize that the proposal is one of tax deferment, not tax forgiveness. Some fears have been expressed that losses in immediate tax revenues would be substantial. This was not the Canadian experience and the law in the Dominion applies to all income earners. Despite misgivings voiced by the Canadian Ministry of Finance, temporary revenue losses amounted only to 18 percent of preenactment estimates. Secondly, the rate of participation will doubtless be far less accelerated than currently estimated. Although aggressively promoted, mutual fund shares reached the $1 billion per year sales level only in 1956 after many years of availability. Mutual savings deposits reached the $1 billion level annually only after a century and war years inflation was a prime factor in this development. It is unrealistic to believe that a Keogh-type program will produce any different experience.

There can be no more appropriate summary to this expression than may be found in Congressman Keogh's own words: "It is my view that in the interest of fairness and equality these people (the self-employed) who are being neglected under our present tax structure are entitled to the consideration that would be given with the enactment of the Jenkins-Keogh legislation. I maintain that it is in the national interest to have our citizens provide for their own retirement rather than having to look toward Federal, State, or local governments for old-age assistance."

Our association, a 105-year-old scientific society of 1,400 Mississippi physicians, earnestly requests your committee to act favorably on H.R. 10 and to support its enactment in the Senate. In behalf of our association, permit me to express our appreciation for your consideration of this statement. We shall hold ourselves in readiness to furnish any additional information which we may be able to supply to your committee if desired.

Sincerely,

LAWRENCE W. LONG, M.D., *President.*

STATEMENT BY WENDELL W. WITTER, PRESIDENT, ASSOCIATION OF STOCK EXCHANGE FIRMS, NEW YORK, N.Y.

My name is Wendell W. Witter. I am president of the Association of Stock Exchange Firms and a partner in the firm of Dean Witter & Co. with main offices at 45 Montgomery Street, San Francisco, Calif. I appreciate this opportunity on behalf of our membership to unqualifiedly endorse H.R. 10.

Our association is a voluntary nonprofit trade body of a major proportion of the member organizations of the New York Stock Exchange. Of the 657 member organizations of this exchange, over 600 conduct their business as partnerships with an aggregate of over 5,000 partners. In addition, there are over 300 individual members of this exchange who conduct their business on the floor of the exchange as sole proprietors in the capacity of traders and specialists. Our members are located in almost every State in the Union and yet only represent a portion of the great number of individuals and partners in the securities industry.

Each partner in our business is a self-employed person, the same as a doctor, lawyer or other professional, farmer, storeowner or other sole proprietor. Each of them is profoundly interested in the general principles embodied in the Keogh bill, and other similar legislation, to encourage the establishment of voluntary pension plans by self-employed individuals. There is a tremendous need for legislation of this nature to afford the millions of self-employed an opportunity to build their own retirement security on a deferred-tax basis similar to that accorded to employees covered by qualified employer-financed pension plans.

For many years our members, along with lawyers, doctors and other self-employed persons, have been seeking equal tax rights and it is eminently unfair that employees of corporations be permitted to provide for their old age on a tax-deferred basis without granting a similar opportunity to the self-employed. Of course, it has been argued that legislation of this nature would substantially reduce Government revenues in the coming years. The far more important issue before Congress is whether the 7 million or more self-employed persons should continue to bear the brunt of this widely admitted tax inequity.

The House of Representatives has again overwhelmingly approved the principles of the Keogh bill and passed it on for your consideration. Now, you, the members of the Finance Committee, have the opportunity to remedy the unfortunate plight of the self-employed with respect to tax-deferred retirement income and correct an obvious inequity. With all the recent legislation adopted to assist small business, certainly this beneficial proposal extending tax-parity to the self-employed should not be overlooked. This legislation has been considered for a great many years and as each year passes the demand for enactment is stronger and more insistent until it can no longer be denied.

The Association of Stock Exchange Firms, on behalf of all its members, wholeheartedly endorses H.R. 10 in the national interest and respectfully urges its enactment.

JACKSON DISTRICT DENTAL SOCIETY,
Jackson, Mich., July 19, 1961.

Hon. HARRY F. BYRD,
Senate Finance Committee Chairman, U.S. Senate, Washington, D.C.

DEAR SIR: As secretary of the Jackson District Dental Society, I am writing to inform you that our society strongly favors the Keogh bill (H.R. 10) and we urge your support of this measure.

After due consideration of this proposed bill, we trust that you and your constituents will see fit to act favorably upon it.

Please include this letter in the record of hearings before the Senate Finance Committee.

Very truly yours,

BLAINE B. JOHNSON, D.D.S.,
Secretary-Treasurer.

PAINTING AND DECORATING CONTRACTORS OF AMERICA,
Chicago, Ill., July 19, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Painting and Decorating Contractors of America is the spokesman for some 8,500 active painting contractors from every section of this great Nation. I do not believe that a better example of the American small businessman can be found than today's painting and decorating contractor. The large majority of these men employ less than 10 workmen. They willingly contribute to welfare and pension funds for their workmen, but are denied the right to set aside any amount for their own retirement on any tax deferred basis. As a national association, we strongly feel that this is working a hardship on these self-employed persons who help make up the backbone of this Nation. We strongly urge that the Senate Finance Committee favorably report House Resolution 10 for the consideration of the U.S. Senate and urge that you use your good influences to obtain this result.

We further request that this statement from this association be included in the written report of the hearings.

Thanking you for your consideration, I am,

Sincerely,

ED S. TORRENCE,
Assistant to the President.

Hopkinsville, Ky., July 22, 1961.

Senator HARRY F. BYRD,
Washington, D.C.:

The members of West Central Dental Society strongly urge your support of H.R. 10.

This society includes a nine-county area in western Kentucky. The society requests that we be in the record of the hearings.

W. B. ADKINS, D.M.D.,
Secretary, West Central Dental Society.

Macon, Ga., July 21, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.:

The Georgia Dental Association is in favor of H.R. 10, the Keogh bill, and urge you to act favorably on it. Please include this message in the record of the hearings.

F. M. BUTLER, Jr., D.D.S.,
Secretary, Georgia Dental Association.

Lawrence, Mass., July 21, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.:

Lawrence Bar Association consisting of over 130 members of the Massachusetts bar urges passage of H.R. 10 and requests that their support be inserted in the record.

EDWARD L. LANIGAN,
President.
THOMAS J. ALLEN,
Secretary.

STATEMENT BY WATSON ROGERS, PRESIDENT, NATIONAL FOOD BROKERS ASSOCIATION, WASHINGTON, D.C.

Mr. Chairman and gentlemen of the Senate Finance Committee, we want to join the large number of organizations and the many self-employed individuals who heartily endorse the provisions of H.R. 10, now being considered by your committee. This bill has been refined to meet the objections of previous years. Your committee's fine efforts last year are reflected in this bill which today has tremendous bipartisan support.

Adopting many of the fine features of your committee bill last session, H.R. 10 is noteworthy for the equitable treatment it provides for self-employed businessmen who desire the ability to establish voluntary pension plans. In addition, employees of unincorporated businesses will profit from such programs in accordance with the language of the bill.

So the committee might recognize the importance of this bill to the members of NFBA we would like to point out that our members are small business people located in every market area of the Nation. The great majority of them come under the category of self-employed business people. To them the present discrimination in our tax laws represents an inequity which requires correction.

The problem of providing for adequate retirement in one's old age is a serious one. Under the present tax law situation, however, self-employed proprietors or partners such as our members cannot adequately make such provision. Many of them do not have the opportunity to participate in pension plans other than Federal social security, the way the situation now stands. As you can understand, they are very anxious to participate in such plans so as to make adequate income provision for their retiring years. This is impossible to do as so many are faced with the almost insurmountable problem of laying aside funds for such retirement purposes after paying great overhead costs and heavy taxes.

The inequity in the situation exists because self-employed individuals such as our members are at a tremendous disadvantage as compared with the officials and executives who work for corporations. As you know, many if not most corporation officials have such protection through the privilege of corporate pension plans to take care of them in their retirement. They are in a position to step down in their later years when they are no longer qualified to take the great pressures of the present-day tempo of our business world. On the other hand, self-employed proprietors cannot do so without great financial sacrifice.

Retirement programs are desirable as they encourage individuals to set aside reasonable amounts of their current income to provide income in their old age. Such thrift should be encouraged. The present tax situation makes this practically impossible for many of our people. H.R. 10, by mitigating the burdensome effect of present tax laws on proprietor and partner individuals, would represent a measure of improvement of small business opportunity and incentive. It would give those people who desire to do so tax savings inducement to set up a retirement program.

Congress has given small business firms an election to be taxed as corporations so as to help small business. However, the old provisions still remain as regards pension trusts. A corporation, no matter how small, can adopt such a plan, but individual proprietorships or partnerships can only adopt pension plans covering employees but not the proprietors or partners. Inasmuch as the Congress is properly concerned with eliminating tax disadvantages and tax discriminations, it would follow that such policy should be included to carry over to pension trust plans. Also, with the provision in the present bill requiring coverage of employees where the self-employed has three or more employees,

the result will be to make available pension plans to many people who otherwise would not have this privilege.

Small business firms should not be forced to incorporate to obtain these advantages. Many of our members find it impractical or undesirable to change from partnership or individual proprietorship to a corporate structure merely to obtain the advantages of being able to set aside, under a tax deferment plan, income to be used for retirement purposes.

For the above reasons, we and our members plead with you gentlemen on the Senate Finance Committee to report this bill out favorably without delay. This equitable correction of a serious burden is sorely needed and should be provided.

CONTRACTING PLASTERERS' & LATHERS' INTERNATIONAL ASSOCIATION,
Washington, D.C., July 24, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

MY DEAR SENATOR BYRD: It is my understanding that hearings will be held on H.R. 10, the Self-Employed Individuals Retirement Act, on Tuesday, the 25th of July.

It would be very much appreciated, Senator, if the committee would accept this letter as a statement for the record.

The Contracting Plasterers' and Lathers' International Association is an organization of lathing and plastering contractors with members in the United States and Canada, but with the great bulk of its membership in the United States.

The Contracting Plasterers' and Lathers' International Association has, at its last several conventions, gone on record unanimously supporting passage of the Self-Employed Individuals Retirement Act. Our board of directors has itself, several times, passed motions indicating the support of the board for this legislation, and many of the local associations affiliated with this international associaiton have also passed similar motions.

The members of this association are all small businessmen. A good number of the members are in unincorporated firms, and have no means of setting up a retirement fund of their own through which they may prepare for the day when they are no longer able to carry on their business.

H.R. 10 would meet the need of the good majority of the members of this association, and, indeed, would meet the needs of a majority of the small businessmen in America today.

The argument that the bill should not pass because other factors of the population are not being taken care of is fallacious. Over the past several decades, the Congress has seen fit to grant to group after group certain privileges, and it is about time that the small businessman gain some of these privileges for himself.

The Congress will be doing the small businessman a great justice by presenting him with the right to set up his own retirement fund. It will make him independent in that the retirement fund will be one which he controls and sets up himself and will not be a fund sponsored by or controlled by the Government.

The CPLIA sincerely urges the Senate Finance Committee to give favorable consideration to H.R. 10, and the CPLIA sincerely urges the Senate of the United States to vote in favor of passage of H.R. 10.

Thank you for your attention to this matter, Senator.

Sincerely yours,

JOE M. BAKER, Jr. *Executive Secretary.*

NORTH ARLINGTON, N.J., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Be advised that I heartily support H.R. 10. Will you kindly see that this communication is placed on record.

Very truly yours,

JOSEPH J. KELLY, *Counselor at Law.*

HACKENSACK, N.J., *July 21, 1961.*

Re H.R. 10.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: You very considerately sent me a copy of the hearings before the Senate Finance Committee on H.R. 10, heard in the summer of 1959. I understand that the committee will begin hearings again on July 25.

As chairman of the committee of the New Jersey State Bar Association in support of this legislation, I have heretofore furnished to Members of the House of Representatives from New Jersey and to our Senators Case and Williams resolutions adopted by the New Jersey State Bar Association at its annual convention in support of this legislation. I know that it is unnecessary to set forth the reasons why the New Jersey State Bar Association as an organization and its members individually believe that H.R. 10 represents an approach to equality of treatment of the self-employed with the great body of employed who are the beneficiaries of very different tax treatment. This letter therefore is to present again to the Senate Finance Committee the fact that the New Jersey State Bar Association endorses H.R. 10 and urges your committee to give it the careful and serious consideration which you have done heretofore and to report favorably on the legislation.

May I add a personal word of compliment to you for the outstanding contribution which you have made in an endeavor to maintain a sound fiscal structure in our economy, and also for your personal consideration in seeing that I received a copy of the 1959 committee proceedings.

Very truly yours,

WARREN DIXON, Jr., *Counselor at Law.*

FORT LEE, N.J., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

Heartily approve and request you endorse H.R. 10. Place this communication in record.

DANIEL A. FIERRO, Jr.

MAURINE HOWARD ABERNATHY,
ATTORNEY AT LAW,
Washington, D.C., July 24, 1961.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR MR. BYRD: I am a practicing lawyer in the District of Columbia and I am the immediate past president of the National Association of Women Lawyers, presently a member of the board, and chairman of the legislative committee. This organization is composed of approximately 1,000 women, who are practicing lawyers throughout the United States; it is the only woman's organization recognized by the American Bar Association, and it is represented by a delegate in the house of delegates of the American Bar Association.

This organization has previously, for a number of years, gone on record as favoring this legislation which would entitle the self-employed to the same tax treatment of retirement savings as enjoyed by corporate employees under pension plans; that is, the right to set aside earnings during the peak years of a lawyer's practice, on which the tax would be deferred to a time when her earnings may be reduced because of age, disability, or other reasons caused by advancing years. We believe the Government should encourage self-employment rather than penalize it by not giving the self-employed the same privileges as big corporations.

The self-employed have gone about their business unorganized, and, therefore, occupy the place of the forgotten man, because they had no one to speak for them. We believe that it is time for this inequity to be corrected.

The National Association of Women Lawyers wishes to thank this committee for giving it the opportunity to submit a statement in favor of H.R. 10 and would like you to include our statement in the record of these hearings.

Sincerely,

MAURINE HOWARD ABERNATHY,
Chairman of the Legislative Committee,
National Association of Women Lawyers.

HIGH POINT, N.C., *July 22, 1961.*

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Information has come to the High Point Furniture Club that the Senate Finance Committee will hold a 1-day hearing July 25 on H.R. 10. We request that our endorsement be included in the records of the committee.

Since more than 100 self-employed wholesale furniture representatives travel far and wide from the High Point area, it is hoped that this long-awaited matter can be constituted into law.

The High Point Furniture Club is the local area group of the Virginia-Carolinas Wholesale Furniture Salesmen's Association, which is closely affiliated with the national organization which works so closely with the House committee.

This bill pased by the House, is designed to encourage voluntary pension plans for self-employed individuals. It will help many thousands outside our industry.

Should your committee desire more representatives for H.R. 10, please have a secretary call me Monday night at Colonial Motel, Winchester, Va. I will be glad to appear any time or place Tuesday. I can very likely arrange to have a Thomasville Chair Co. (one of the largest furniture factories in the South) representative there too.

Senator, every man in our industry, without regard to party, creed, or color, commends your untiring efforts in watching the U.S. Treasury. Many of your constituents in Norfolk with whom I do business keep affirming this. It is hoped that some day that Treasury will be as neat, businesslike, free from debt as your Berryville orchards are the envy of all U.S. applegrowers.

Respectfully yours,

C. G. MACKINTOSH,
President, High Point Furniture Club.

STATEMENT OF THE NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

The National Society of Professional Engineers is a nonprofit, membership organization composed of professional engineers in virtually every specialized branch of engineering practice and type of employment. All of the society's 56,000 members are registered under applicable State engineering registration laws, and are affiliated through 53 State societies and approximately 400 local community chapters. The national society was organized in 1934 and is dedicated to the advancement of the public welfare and the promotion of the profession of engineering as a social and economic influence vital to the affairs of men and of the United States.

The views of the society expressed herein with respect to H.R. 10 are designed to supplement the presentation of the American Thrift Assembly. The National Society is a contributing member organization of the ATA and is represented on both its board of directors and executive committee. We would state for the record that we fully endorse and support the position taken by the American Thrift Assembly on H.R. 10.

It is not a novel thought to mention that recent international developments have pointed up this Nation's need for skilled brainpower. One need only pick up a daily newspaper to read about the various proposals which have been advanced for the Federal Government, State and local governments, industry and educational institutions to meet this requirement. It is not our purpose, of course, in this presentation to discuss the relative merits of the diverse programs which have been suggested to improve and stimulate the output of our engi-

neers and scientists. There is, however, before this committee a House-approved Federal program by way of tax equalization which can materially aid our technological progress, which everyone agrees is so vital if we are to maintain our status as a free nation and a world power.

To state this point in as concise manner as possible, it may be said that H.R. 10 would encourage our engineers and scientists to achieve that degree of self-reliant individualism which is so vital for the fullest development of their technical competence. A scientist or engineer who may be classified as a self-reliant individual is one who, upon his own initiative and drive, seeks more than that which is offered him in a formal undergraduate education. He has the desire to expand his range of knowledge and explore the unknown or undeveloped. He has enough fortitude, if you will, to follow his own convictions toward the solution of a problem or the fulfillment of a dream. It is this type upon whom the future security of our Nation depends.

Without having to place undue emphasis on the factor of personal security in his choice of an avenue through which he will offer his knowledge, the scientist or engineer, assured of the benefits of a comprehensive and fair retirement program, would be free to offer his services through the channel which, according to his individual opinion, would prove most productive for his technical talents. By permitting a self-employed consulting engineer, for example, an opportunity for retirement benefits equal to those of his professional brothers who are not self-employed, the Keogh-Utt bill will materialy assist his opportunity for freedom of thought and activity.

It should be made clear that a large segment of the Nation's engineers and scientists are employees and in that capacity come under the employer's retirement program. It will probably always be true that the majority of engineers and scientists will be employees. Nothing stated here should in any manner be construed as lessening the great importance of this part of the profession to our economic development and scientific advancement.

There is, however, a growing recognition of the necessity and desirability of looking toward the self-employed consultants for certain research and development aspects of the defense program. This is particularly so in the case of highly specialized and unique technological problems which a self-employed consultant may be in a better position to handle on an efficient and expeditious basis.

There are a number of definite advantages to the Government and industry in using consulting engineers fo rcertain supplemental or highly specialized aspects of a project. Flexibility of operation is a distinct advantage, in that a consultant may provide his special knowledge and skill to highly complex aspects of the project to a number of firms or governmental agencies. Were it not for this type of special arrangement such organizations would, in many cases, be required to maintain a highly skilled specialist on the permanent staff even though there was not a continuous need for that special service. This exemplifies the urgent necessity of encouraging and maintaining a strong engineering and scientific consulting force in this country to provide such highly technical services, and to utilize the special talents of the consultants to the maximum degree.

Computer technology is now an indispensable element in efficient development of modern defense techniques and other scientific processes. Some of this highly complicated work can be done effectively on a full-time employee basis. Other aspects, however, require tremendously expensive equipment and highly specialized training, and often it is most efficient to retain a consultant who has this equipment, knowledge, and experience to deal with a particular problem. There are many other similar examples wherein the consultant is vital to the defense operation, such as electronic control equipment development, temperature control techniques and devices, and communications systems, to mention only a few.

It should also be noted that the use of consultants along the lines indicated has the very important advantage of promoting the most effective utilization of the scarce skills which plague our defense efforts. The former President's Committee on Engineers and Scientists, as well as other agencies and individuals who have studied the engineering and scientific manpower picture, agree that improved utilization is the most important thing we can do now to meet our skilled personnel needs. If we may quote from our own public statement on the manpower question: "Experience has shown that we have wasted engineering talent by using it at a level below that which it is capable of performing. Improved utilization of engineering talent can do more for an immediate need than any other single program."

From the standpoint of the total national welfare, then, we submit that it is vitally important for the Federal Government to do what it reasonably and properly can to place no roadblocks in the paths of those whose specialized knowledge may best be utilized as self-employed consultants. It is obvious, of course, that the present Federal tax laws are a roadblock for such persons because of the penalty which must be paid by the self-employed in terms of retirement income protection. The Keogh-Utt bill will remove that roadblock.

Another phase of this problem which is of general national concern is that we must do a better job of identifying, stimulating, and helping those young people who have the aptitude for engineering and scientific study into making these vital professions their career choice. How does this responsibility relate to H.R. 10? Simply this: Self-employed retirement programs can prove to be one of the important elements of all the factors considered by young people when they weigh various paths of career developments and fields of endeavor. Furthermore, H.R. 10 would be a major contribution toward the enhancement of the professions from an economic standpoint and would assist in establishing a climate favorable to the professions for career development. Surely, we will do well to recognize that these young people are aware of the economic aspects of various career choices and are conscious of the widespread pattern of retirement income protection. The Keogh-Utt plan will, of course, enable the professions to approach some degree of equality with other groups in this respect and thus make the choice of a professional career more attractive.

The stimulating drive which serves to keep our highly capable scientists and engineers mobile and adaptable is the relatively constant need to solve diverse problems in a variety of ways or methods, depending upon the particular company or agency which has engaged the services of the consultant. The varying circumstances surrounding each project serve to help the consultant keep abreast of changing developments and processes and allow him to perform a variety of jobs with a high degree of facility.

Such technological versatility is essential to our economy today. A tax equalization program such as that proposed by H.R. 10 will do much to stimulate and encourage the development of the self-reliant, individualistic scientist or engineer who is free to take the risk of establishing a general or specialized consulting office so that he may offer clients new ideas, techniques, or methods—the lifeblood of technological progress—without having to pay the penalty of sacrificing personal security which is available through the retirement programs of employers under the current provisions of the Internal Revenue Code. Given that degree of self-assurance recommended by the Keogh-Utt legislation, the ingenuity and resourcefulness of America's engineers will not let us down.

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS BY CURTIS E. HUBER, CHAIRMAN, REALTORS' WASHINGTON COMMITTEE

Mr. Chairman and members of the committee, my name is Curtis E. Huber and I am a realtor engaged in the brokerage business in Evansville, Ind. I am testifying on behalf of the more than 69,000 members of the National Association of Real Estate Boards, the large majority of whom would be directly affected by enactment of this bill. It is consistent with the professional nature of their work that they do business in a noncorporate form, and most of them, therefore, are self-employed. Because of this, the present tax inequality which exists relative to pension plans for the self-employed affects them adversely just as it does doctors, lawyers, and others. There is therefore overwhelming support in our association for passage of H.R. 10. At our national convention in November 1960 we adopted the following resolution:

"We oppose the inequity in the Federal tax code which requires brokers to incorporate in order to be permitted tax deductions of contributions to pension and profit-sharing plans. We urge the Congress to permit such deductions by partners and proprietors."

In view of the difficulties experienced last year in appending to H.R. 10 amendments relating to corporate pension plans, we urge the committee to consider the present bill as it relates to the problems of the self-employed. We think the bill in its present form provides a flexible method for self-employed persons to establish pension plans for themselves and, at the same time, assures adequate protection of the interests of employees.

The bill incorporates many of the improvements made by this committee to the bill during the 86th Congress, and modifies others.

The provisions covering deductions of owner-employees is much simpler and more flexible than the corresponding provision in last year's bill. While in that bill, the owner-employee could deduct a greater percentage of his salary than he deducted from employees' salaries (one-half of total vested amount contributed to employees), the present provision would impose the nondiscriminatory limitation presently found in corporate plans. This limitation appears to me to lessen the revenue loss which would be caused by passage of the bill.

The distinction between owner-employees with three employees or more and those with less than three employees is another improvement which we strongly indorse. In a firm with two or three employees, the chance that any one employee will stay with the firm until retirement is much less than it would be if the firm were larger. At least one, and probably more, would be clerical or secretarial employees who would not be expected to stay that long. The present bill would not require that the owner-employee with three or fewer employees risk the loss of vested contributions because of turnover in order to establish his own plan. It is only fair, however, to limit this type of employer to a maximum deduction of the lesser of $2,500 or 10 percent of income.

The bill presently provides for the use of custodial accounts as a means of funding retirement plans if the funds are invested in a regulated investment company issuing redeemable shares. We urge the adoption of an amendment which would also allow custodial funds to be invested in shares of a qualified real estate investment trust. As the committee knows, these trusts are essentially passive, holding real estate and mortgages for investment purposes, and, by legislation enacted last year, are taxed only on undistributed taxable income if they distribute at least 90 percent of that income to shareholders. These trusts were created in order to allow small investors to pool their money in real estate investments and be accorded the same tax treatment as investors in regulated investment companies.

A proposed amendment which would accomplish this purpose is attached.

There is no danger that pension funds invested in real estate investment trusts would not be adequately protected. The legislation concerning these trusts imposes many qualifications, soon to be implemented by thorough regulations issued by the Internal Revenue Service. In addition, because of the 100-shareholder requirement, these trusts must register all share offerings with the Securities and Exchange Commission.

In conclusion, we cannot emphasize too strongly the need for this legislation. As we pointed out in our testimony before this committee in 1959, a real estate broker, as well as other self-employed persons, must resort to elaborate procedures under the Tax Code in order to obtain pension plan privileges equal to those of corporate employees. He must either try to incorporate and elect to be taxed as a partnership under subchapter S or, if this is not possible, to qualify as an association taxable as a corporation. As the members of the committee well know, this former method involves much uncertainty and imposes many restrictions on the corporation, and the latter method, also uncertain, could be used only at the broker's tax disadvantage.

It is certainly not desirable to force a self-employed person into these legal maneuvers simply to nullify an easily removed tax inequity. Indeed, this is exactly the opposite effect intended by enactment of subchapters R and S. It was hoped that these subchapters would eliminate tax considerations from the choice of a particular form of doing business. In the case of the self-employed person attempting to overcome a tax inequity and to establish a pension plan for himself, however, the tax consideration is the only factor affecting this choice.

We urge favvorable consideration of H.R. 10 as a means of placing the self-employed person on a par with corporate employees.

PROPOSED AMENDMENT TO H.R. 10

On page 20, line 7, after the word "stock", insert the following: "or real estate investment trust shares".

On page 20, after line 21, add a new paragraph (3) as follows:

"(3) For purposes of paragraph (1), the term "real estate investment trust" means an unincorporated association or unincorporated trust which meets the requirements of section 856."

NATIONAL ASSOCIATION OF PLUMBING CONTRACTORS,
Washington, D.C., July 25, 1961.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The National Association of Plumbing Contractors is composed of approximately 10,000 members who do about 80 percent of the total volume of plumbing contracting in the United States. Government estimates indicate there are about 80,000 plumbing contractors in the country doing a gross business of $2 billion annually. The vast majority of these contractors are small shops and as such qualify as small businessmen. Our association has 40 State associations and approximately 300 local affiliated groups.

There are very few plumbing contractors who come under the heading of big business, in fact, there are less than a dozen contractors in the entire country who employ 500 persons or more. These few are apparently highly seasonal in nature; so that few, if any, companies have 500 employees on their payrolls all year long.

Our members and this is true of most self-employed, seldom have the same income year in and year out. It is not unusual for a plumbing and heating contractor to do twice as much business in 1 year as he does in another, because of the way business goes in the construction industry. This instability in business and earning power creates an extremely serious problem for the individual proprietor in making provision for his old age.

We realize that a good deal of opposition to H.R. 10 comes from people who believe this would result in a serious loss to the Treasury. However, testimony before your committee in the last Congress indicated that such estimates have greatly exaggerated the possible loss in the years immediately ahead.

The National Association of Plumbing Contractors feels that a measure like H.R. 10 would help keep many people from incorporating to reduce their taxes. There are a number of plumbing and heating contractors who could have saved considerable money during the past few years on their income tax by incorporating their businesses.

We know of a number of contractors whose contract business can put them in the 90-percent bracket one year, and whose books show practically no profit the next year, so incorporation is not only a tax savings, it means actual survival in competition.

In conclusion, we would like to briefly illustrate how two typical plumbing contractors have reacted to the existing tax laws.

One is a substantial Chicago contractor, whose business fluctuates from year to year as I have just described. This contractor has now incorporated and his business is running on a much smoother keel than it did before. But what made him incorporate was not this inconsistency in the tax law. It was another inconsistency.

It worked like this:

In Chicago, 88 percent of the plumbing contractors are self-employed. They average about 10 employees each. All these men are covered by a pension plan provided by the contractors, as fringe benefit, under an areawide labor-management agreement. Those employers who are self-employed plumbing contractors cannot provide similar protection for themselves except out of their income after taxes. In other words, my self-employed contractors friend was not eligible for the same pension benefits he had to pay his own employees.

There is another contractor in our association who expressed his views as follows:

"You probably wonder why I don't incorporate. Well, I have a lot of reasons, but the main one is that I am afraid that I would run the risk of losing control of the business. My father started our family business in 1925, and I have carried it on since 1937. Now, I have a son who has been with me for some 5 years. In another 2 years I think he will be ready to take the business over. If I incorporate, however, even just by giving stock to two or three outsiders, I would have to bring in people from outside my family in order to satisfy the requirements for incorporation."

Sincerely,

G. ALLEN BRIGGS, *President.*

STATEMENT OF GEORGE J. BURGER, VICE PRESIDENT, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

Speaking for the more than 170,000 individual independent business and professional people from all 50 States of this country, individuals who are active, current members of this federation, we urge that you act favorably on bill H.R. 10, a bill that rights an injustice in our laws which permit corporations to take tax deductions for payments into private retirement funds for their officers and employees, yet prohibit self-employed business and professional people from enjoying the same opportunities.

Please understand, we are not telling you what we or any small self-appointed group think our members want. We are only reporting to you what our members themselves have told their Congressmen and told us in repeated soundings in Federation nationwide membership mandate polls—in which each of our members has had one and only one vote—and in the course of which members have sent their voted, signed, and thereby authenticated, opinions to their Congressmen.

In the latest of these polls (conducted in mandate No. 264, mailed during April this year to our then total 160,800 members), we polled independents on the following question:

"H.R. 10 and S. 59, private retirement plans: * * * help self-employed professional and businessmen finance their own private retirement programs, by exempting from tax the first 10 percent of yearly income paid into their programs." (Representative Keogh, New York, and Senator Smathers, Florida.)

In line with our policy of remaining neutral in these polls, and to assist independents in intelligently appraising the issues involved, we furnished our members with the following comments "for" and "against" H.R. 10 and S. 59:

"Argument for H.R. 10 and S. 59: These bills provide a system whereby the self-employed such as unincorporated small businessmen in all vocations as well as professional people (doctors, lawyers, etc.) can be covered under approved pension plans similar to those presently enjoyed by most corporation employees. The bills aim to give equality of opportunity to the self-employed to set aside a portion of their income for their old age, in much the same manner as corporate employees now contribute to company operated pension plans."

"Argument against H.R. 10 and S. 59: These bills would only drive new loopholes (no matter how worthy) into our present tax laws which already have so many loopholes for interest groups that they collect taxes like a soup-strainer. What we need rather than this is a general overhaul of taxes, to close loopholes, plug up the leaks, then a gradual hammering down of tax rates all along the line. This is the fairer, more sensible approach, and would leave the self-employed with more money in their pockets to provide for their old age."

As reported in mandate No. 265, in thousands of votes cast, signed, and mailed to their Congressmen, 78 percent of our members favored enactment of H.R. 10 and S. 59; 18 percent opposed the legislation, while 4 percent expressed no opinion either way on same. Undoubtedly, many Members of the House who received ballots in this poll have retained them in their files. Records maintained at federation headquarters can authenticate these percentages. We reported results of this vote on a State-by-State basis to each of the 100 Members of the Senate, including the members of your Committee on Finance.

By itself, the results of this and other polls on these bills are significant. Their significance becomes much greater, however, when two additional facts are recognized: (1) That these polls are taken among the largest single individually and directly supported business organization in the country, and (2) that members of the federation, located in all parts of our country, cover all the various types of enterprise in our Nation—ranging from operators of diaper services and rabbitries to doctors, lawyers, certified public accountants, and local bankers—which makes them a truly representative cross section of all small business enterprise everywhere.

In this connection, several other points are of interest:

First, for the past 6 months we have been conducting a special poll among our members concurrently with our mandate polls through which we have been determining small business' main problem areas. We have been furnishing detailed results of findings in this poll to the Senate Small Business Committee. In any case, this poll has shown that taxes are considered the No. 1 problem area. A goodly number of our members have taken the trouble, when replying to this special poll, to suggest enactment of H.R. 10 and S. 59 legislation as a

step in the right direction of correcting tax problems. Perhaps the Senate Small Business Committee has advised you of this fact.

Second, just recently we made a special nationwide survey of the federation's 2,354 district chairmen, in all 50 States, as to their attitude on the different phases of the President's 1961 tax revision program. A report on this survey has been furnished to your committee, including hundreds of personal comments by independents giving their views in depth. Very definitely the results of this survey reflect an urgent need for tax relief and we are quite sure that our chairmen would welcome enactment of H.R. 10 and S. 59 type legislation as a step in the right direction.

One final point: We have more than 200 full-time field representatives who visit and talk with upward of 2,000 independent business and professional people in all parts of the country each and every day. They are, in part, a portion of our factfinding program. Their reports to us last summer, when there was hope that the Senate would follow in the footsteps of the House in finishing action on H.R. 10 and S. 59 type bills, were of finding a great upsurge of optimism and happiness among independents visited, followed (after the conventions) unfortunately by a mood of deep depression when the Senate adjourned without acting on the bills. Later they found considerable satisfaction when the candidates of both political parties committed themselves and, to the extent they were able, their parties to this type of legislation. And, just this spring, they found much renewed optimism following favorable House action on H.R. 10.

The long and the short of it is that, faced with ever-rising costs, reduced profit margins (due to intensified competition), and continued high tax rates, independents are finding it increasingly difficult, if not impossible, to lay away funds for retirement years. They see assistance available to corporations for their officers and employees, but denied them. They look to you for help in correcting this situation. They read and hear, these days, much about the problems of our senior citizens and what is proposed to be done and is being done to assist them. They know one day they and their wives will be in that category. They urge your favorable action on H.R. 10 and companion bills to help them meet their needs when they join the ranks of our senior citizens.

WEST ENGLEWOOD, N.J. *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.:

Strongly urge passage of H.R. 10 as sorely needed relief for self-employed. Kindly place this communication on record.

RAYMOND G. BETSCH.

GARFIELD, N.J., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
New Senate Office Building,
Washington, D.C.:

Please be advised that we support H.R. 10 bill and asking that our communication be placed on record.

ARTHUR J. MESSINEO, *Attorney.*

NEW YORK, N.Y. *July 25, 1961.*

Senator HARRY F. BYRD,
Washington, D.C.:

The members of the New York State Optometric Association desire to go on record as recommending favorable action upon H.R. 10 which would permit the self-employed to augment their social security status. Optometrists are self-employed professional men and are generally in private practice and, therefore, this bill would enable them to supplement their social security benefits in their later years. The members of this association, therefore, respectfully request that your committee act favorably upon bill H.R. 10.

ALDEN N. HAFFNER, *President.*

SANTA ROSA, Calif., *July 21, 1961.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: The Redwood Empire Dental Society, serving Sonoma, Lake, and Mendocino Counties, favors the passage of H.R. 10. It is requested that this telegram be included in the record of your hearings.

R. C. BELL, Jr., D.D.S., *Secretary.*

WASHINGTON, D.C., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.:

The Bar Association of the District of Columbia joins with other associations representing self-employed persons in urging favorable action by the Senate Finance Committee on H.R. 10 passed the House of Representatives on June 5, 1961. Its enactment would make it possible for self-employed attorney's to achieve a retirement plan comparable to that which they might attain if employed by industry, a result which is only fair to self-employed persons such as lawyers in private practice. It is requested that this telegram be made a part of the record of your hearings on H.R. 10.

EDMUND D. CAMPBELL,
President, the Bar Association of the District of Columbia.

NEW ORLEANS, LA., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee, Washington, D.C.:

Our society adopted resolutions November 1956, reaffirmed May 1961, supporting Jenkins-Keogh bill. Strongly urge favorable consideration H.R. 10 to correct tax inequity. Request this wire be included in record of Senate Finance Committee hearing on this measure.

J. CLAUDE EARNEST, D.D.S.,
President, Louisiana Dental Association.

RESOLUTION [1]

Whereas the Internal Revenue Code grants to corporate officials and employees substantial income tax savings on certain amounts contributed to a corporate pension or retirement program for the benefit of these officials and employees; and

Whereas similar tax savings are not granted under the law to self-employed individuals in connection with amounts contributed by them to their private pension or retirement programs; and

Whereas, legislation, popularly known as the Jenkins-Keogh bills, to correct this tax inequity and to encourage sound saving practices on the part of self-employed individuals has been before the Congress for the past 6 years; and

Whereas during this period the essential equity of the Jenkins-Keogh proposal has been proven by irrefutable evidence and has gained the endorsement of both political parties and of the President of the United States: Therefore, be it

Resolved, That the membership of the Louisiana State Dental Society supports the principle of the Jenkins-Keough proposal which would entitle self-employed individuals to realize tax savings on specified amounts contributed to voluntary pension or retirement programs comparable to the tax savings enjoyed by corporate officials and employees in connection with their pension or retirement programs; and be it further

Resolved, That the membership of the Louisiana State Dental Society urges the 85th Congress to enact this proposal into law and asks each member of the Louisiana congressional delegation to lend his leadership and influence in the Congress to the achievement of this objective at the earliest possible date.

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[1] Louisiana Dental Association, minutes of meeting, November 1956.

ADLER & WINICK
ATTORNEYS AT LAW,
Englewood, N.J., July 24, 1961.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SIR: Please be advised that this firm is in favor and in support of H.R. 10 and we favorably recommend its passage.

We feel that this type of legislation would be of great benefit to the professional and self-employed individual.

Would you kindly place this communication in the record in support of such legislation on behalf of our firm.

Very truly yours,

IRVING I. WINICK.

SAMUELSON & MARKS,
COUNSELORS AT LAW,
Hackensack, N.J., July 24, 1961.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I have worked very hard building a private law practice. As you may know, the struggle was primarily financial. It seems unfair that self-employed persons should pay during years when their peak incomes will probably be received, considering the average income during a self-employed person's lifetime. I therefore urge you to do what you can to pass the Keogh bill H.R. 10.

Would you kindly place this communication in the records.

Very truly yours,

LEO H. MARKS.

LORCHE & LORCHE,
COUNSELORS AT LAW,
Hackensack, N.J., July 24, 1961.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I respectfully urge your support of H.R. 10 and ask that this request be added on the record to those also in favor of it.

Respectfully yours,

BRUCE H. LORCHE.

RAMSEY, N.J., *July 24, 1961.*

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: The lawyers of our country, as well as other self-employed individuals, have been sadly neglected as far as old-age protection is concerned.

H.R. 10 is a step in the right direction and I urgently request your support of it and ask that this request be placed in the record.

Your consideration and cooperation will be very much appreciated by all self-employed individuals across the Nation.

Sincerely,

MORRIS N. SCHARF, *Counselor at Law.*

BEST AVAILABLE COPY

PATERSON, N.J., *July 24, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: It is my understanding that the Keogh-Utt bill (H.R. 10) is scheduled for a hearing on July 25, 1961, before the Senate Finance Committee.

Your support is earnestly requested to the end that the above bill may be adopted and provide some relief for the self-employed. I would appreciate your placing this communication on the record as being in favor of the passage of the above bill.

Very truly yours,

CHARLES J. KAHWATY, *Attorney at Law.*

HENDIT, WEINSTOCK, CUMMIS & KRONER,
COUNSELORS AT LAW,
Newark, N.J., July 24, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR: It has been brought to my attention that the Senate Finance Committee under your chairmanship will have a hearing on July 25, on the Keogh-Utt bill, H.R. 10.

It is my understanding that this proposed legislation will permit tax deductions for the purpose of creating retirement funds by the self-employed.

The present status of our tax law which does not permit the self-employed to create such retirement funds with the aid of tax deductions is a discriminatory practice against the self-employed for which I find no reasonable basis. H.R. 10 would eliminate that discriminatory practice and place the self-employed on equal footing with the other wage earners of our country. It appears to me that this is in the public interest and that therefore this bill should meet with favorable approval by your committee and by the Senate.

I would respectfully request that my communication be placed in the record in support of the passage of that bill.

Respectfully yours,

CLIVE S. CUMMIS.

STATEMENT PRESENTED TO THE FINANCE COMMITTEE OF THE SENATE ON BEHALF OF THE AMERICAN OPTOMETRIC ASSOCIATION BY HAROLD W. OYSTER, O.D.

Mr. Chairman and members of the committee, my name is Harold W. Oyster. I am an optometrist practicing in Marietta, Ohio, and director of the department of national affairs of the American Optometric Association.

I have served as president of the Ohio State Optometric Association, have been that association's liaison officer to the Ohio State University School of Optometry for the past 13 years, and a member of the Vision Conservation Advisory Board of the Ohio State Department of Health.

I am a member of the House of Representatives of the Ohio Legislature where I am serving my sixth consecutive term.

I was a lieutenant (senior grade) in the U.S. Naval Reserve for 2 years during World War II, and was on board the U.S.S. *Vincennes,* a cruiser attached to the Pacific Fleet.

I am a member and have been active in such organizations as the American Legion, Disabled American Veterans, Marietta Lions Club (past president), Farm Bureau, Grange, Knight of Pythias, Odd Fellows, and several Masonic Orders.

Two years ago, Dr. V. Eugene McCrary appeared before your committee on behalf of the department of national affairs of the American Optometric Association and supported the passage of H.R. 10 as it was passed by the House of Representatives in the 86th Congress.

BEST AVAILABLE COPY

Our association is a member of the American Thrift Assembly which, as you are all aware, has been actively supporting the passage of this legislation.

It is not my intention to repeat what has been and will be presented by the American Thrift Assembly and the other organizations representing self-employed persons whose members are engaged in industry, agriculture, or one of the professions.

There are somewhere between 18,000 and 20,000 licensed optometrists in the United States, considerably more than half of whom are members of our association. Most of these are self-employed. Many of them live and practice their profession in the smaller communities where their patients would have to travel from 50 to several hundred miles to obtain the service of an ophthalmologist. It is distincly in the public interest that these men be encouraged to continue to serve the public in these smaller communities.

On the other hand, with the ever increasing cost of living, and the inadequacy of those benefits provided by the old-age and survivors insurance provisions of the social security law, to supply the standard of living which a reasonably successful self-employed person has enjoyed, they must augment their social security benefits. Yet it is practically impossible to do so under our present tax structure. One of the results is that the professional schools of this country, including medicine, law, dentistry, as well as optometry, are finding it more difficult to recruit a sufficient number of qualified students to meet the demand which is bound to expand simply by reason of population growth. One of the primary reasons is the fact that employees of corporations are offered retirement benefit pension plans, etc. the advantages of which far exceed any which a young man may hope to create for himself if he spends his productive years as a solo practitioner in a profession. The Federal State and local tax collectors leave little or nothing for savings even in prosperous years.

Therefore, I submit that it is not only a matter of justice to the self-employed individual that H.R. 10 should be enacted into law, but it is in the public interest in that by so doing Congress will provide an added incentive for the youth of our country to acquire a professional education, and to engage in what is normally referred to as a "solo practice" in smaller communities as well as in large metropolitan areas.

It was never the intention of the sponsors of our social security system that it should provide any more than the basic requirements for retired individuals.

If our Nation is to remain strong and to demonstrate to the world that our form of Government is not only effective but the best that has thus far been devised, then we must provide equality of opportunity for the individual to augment his social security retirement benefits regardless of whether he is self-employed or the employee of one of our large corporations all of which have pension plans not only for the executives and white collar workers but for their laborers as well.

AMERICAN RETAIL FEDERATION,
Washington, D.C., July 24, 1961.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington D.C.

DEAR MR. CHAIRMAN: The American Retail Federation wishes to go on record in support of H.R. 10, titled "The Self-Employment Individual's Retirement Act."

In a referendum conducted by the federation, the member associations (see list attached) overwhelmingly endorsed the principles contained in H.R. 10, as the most feasible and practical means of correcting a long-standing discrimination against the self-employed taxpayer as to the tax treatment given to funds set aside for retirement. Our members know of no reason why the self-employed should be discriminated against in this manner.

The retail industry is an industry of small independent businessmen. The most recent figures available on the retail industry come from the 1954 Census of Business. That census indicates the retail industry is comprised of 1,721,650 retail outlets of which 86.5 percent or 1,489,355 outlets were operated as proprietorships and partnerships.

Over 900,000 retail establishments operating as partnerships and individual proprietorships have annual sales of under $50,000; and 268,000 have sales between $50,00 to $100,000 annually. About half of these stores have no employees—being operated solely by the proprietor or the partners. The other hlf which do have employees would have only a small number.

While these individual partnerships and proprietorships within the retail industry constitute over 86 percent of the total retail outlets, they also move into the hands of the consumer 50 percent of all the goods and commodities sold through retail outlets. By maintaining competition within our industry, these smaller firms make a valuable contribution to our national economy.

The current discrimination between the employed and the self-employed has existed for almost a full generation. It was in 1942 when the Congress amended the Internal Revenue Code to permit special tax treatment for private pension plans which qualified under the Code and which were certified as such by the Treasury Department. The amendment was designed to encourage the creation of private pension plans to take care of employed people in their older years when their earning power had diminished.

These tax considerations have played a vital role in the tremendous growth of private pension plans. Today, close to 19 million employed workers are covered in plans which have been approved by the Treasury Department. This means that the money which is set aside to provide retirement income is not taxed as income to the employee until he receives the income as a pension. It also means that the Treasury Department recognizes that the funds contributed by the employer are part of the necessary cost of doing business.

The Congress is to be commended for the enactment of this legislation. It is indeed sound public policy for the Federal Government to encourage the establishment of annuity plans and pension trusts in order that employed workers can enjoy their senior years in security and comfort.

The social and economic benefits which are derived from this wise provision are so widely recognized today that there is no serious suggestion from any responsible source that this incentive be removed from our tax laws. However, the time is long overdue for the Congress to give the same consideration to the self-employed.

May I call to the attention of this committee that the discrimination against the self-employed was adopted in 1942, which I need not point out was an emergency year. Only a few months after the attack on Pearl Harbor when this Nation was hurled into the greatest war in all history, and at a time when Federal expenditures were exceeding income by tremendous proportions, Congress adopted an amendment to the Internal Revenue Code to stimulate the establishment of pension plans for the employed worker. It is indeed difficult for the self-employed to understand how the Congress could grant tax concessions for the employed in those trying days and deny them to the self-employed during the last 19 years.

The retail industry is composed of business enterprises, both large and small, both incorporated and nonincorporated. We believe that the self-employed are entitled to the same advantages under our tax laws as are the employed. In urging enactment of this measure, the small retailer is not seeking any Government favors or subsidies. He fully realizes any funds set aside for retirement purposes must first be earned and then saved.

We sincerely hope that your committee will act favorably on H.R. 10 in order that this long-standing discriminatory treatment of the self-employed can be erased from our tax laws. The self-employed have waited long for appropriate action. We hope they will receive it this year.

It is requested this be made part of the hearing record on H.R. 10.

Respectfully submitted.

WILLIAM C. MCCAMANT.

STATE ASSOCIATIONS

Alabama Council of Retail Merchants, Inc.
Arizona Federation of Retail Associations.
Arkansas Council of Retail Merchants, Inc.
California Retailers Association.
Delaware Retailers' Council.
Florida State Retailers Association.
Georgia Mercantile Association.
Idaho Retailers Association, Inc.
Illinois Retail Merchants Association.
Indiana Retail Council, Inc.
Iowa Retail Federation, Inc.
Kentucky Merchants Association, Inc.
Maine Merchants Association, Inc.
Maryland Council of Retail Merchants, Inc.
Massachusetts Council of Retail Merchants.
Michigan Retailers Association.
Minnesota Retail Federation, Inc.
Mississippi Retail Merchants Association.
Missouri Retailers Association.
Nebraska Federation of Retail Associations, Inc.
Nevada Retail Merchants Association.
New Jersey Retail Merchants Association.
New York State Council of Retail Merchants, Inc.
North Carolina Merchants Association, Inc.
Ohio State Council of Retail Merchants.
Oklahoma Retail Merchants Association.
Oregon Retail Council.
Pennsylvania Retailers' Association, Inc.
Rhode Island Retail Association.
South Dakota Retailers Association.
Tennessee Retail Merchants Council.
Texas Retail Federation.
Utah Retail Merchants Association.
Virginia Retail Merchants Association, Inc.
Washington Associated Retailers.
West Virginia Retailers Association, Inc.

NATIONAL ASSOCIATIONS

American Retail Coal Association.
Associated Retail Bakers of America.
Association of Family Apparel Stores, Inc.
Institute of Distribution, Inc.
Mail Order Association of America.
National Appliance and Radio-TV Dealers Association.
National Association of Chain Drug Stores.
National Association of Music Merchants, Inc.
National Association Retail Clothiers & Furnishers.
National Association of Retail Grocers.
National Council on Business Mail, Inc.
National Foundation for Consumer Credit, Inc.
National Industrial Stores Association.
National Luggage Dealers Association.
National Retail Farm Equipment Association.
National Retail Hardware Association.
National Retail Tea & Coffee Merchants Association.
National Shoe Retailers Association.
National Sporting Goods Association.
Retail Jewelers of America, Inc.
Super Market Institute, Inc.
Variety Stores Association, Inc.
Women's Apparel Chains Association, Inc.

AMERICAN MEDICAL ASSOCIATION,
Chicago, Ill., July 24, 1961.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: On behalf of the American Medical Association I would like to present our views with respect to H.R. 10, 87th Congress. While we would prefer to present our position on this legislation personally before your committee, we will present them in this form in the interest of saving the committee's time. We would also appreciate your arranging for this letter being made part of the record of the hearings.

As you will recall, our witnesses before your committee in the 86th Congress, Drs. George M. Fisher of Ogden, Utah, and Vincent W. Archer of Charlottesville, Va., reviewed the association's history of support of this type of legislation, which dates back to 1948. The latest action by our house of delegates on this type of legislation was taken at our recent annual meeting in New York City in June 1961. The resolution adopted by the house of delegates reads in part:

"Whereas voluntary pension and retirement funds entered into and supervised for the individual embody the principles of self-determination and self-responsibility which have contributed greatly to the strength of this country, and

"Whereas, the house of delegates of the Arizona Medical Association, Inc. in annual meeting recently concluded again reaffirmed its support for Keogh-Bennett tax legislation and all other similar efforts to provide all self-employed individuals, including physicians, nurses, and other segments of the medical profession, with the opportunity to save and plan for their own retirement: Therefore be it

"*Resolved*, That the house of delegates of the American Medical Association reaffirms its support of such Keogh-Bennett-type legislation to assist the self-employed to plan for their own retirement; * * *"

In addition it should be noted that most of the State and local medical societies have also gone on record favoring this legislation. I understand that a number of these resolutions have been referred to your committee.

The present corporate pension plan provisions of the Internal Revenue Code were enacted in October of 1942, when this country was engaged in the most costly war in the history of man. Currently, some 20 million persons are covered under its terms, the tax on their benefits being deferred until the individual receives them. That the physicians of America endorsed this program is indicated by the fact that they instructed the American Medical Association to establish such a program for its employees.

At the same time, as indicated by the association's long history of support of the legislation currently before the committee, physicians believe that the existing law is inequitable in that it excludes the self-employed. It is the belief of the American Medical Association that physicians, dentists, veterinarians, lawyers, architects, the merchant in his small store, the gas station owner, the farmer and the rancher, and the many others who comprise the Nation's self-employed have been too long neglected in Federal tax legislation relating to pensions.

Nor is this only reason for our support of this legislation. As Dr. Fister, our new president-elect, pointed out before this committee in his 1959 testimony, we are concerned about the growing trend among professional people to seek the security of an employed in preference to independent status. At that time he stated in part: "A continuation of this situation may not only limit individual initiative but may also create a shortage of medical services in certain areas. For example, it could contribute to a maldistribution of physicians since it makes the large city more attractive to the young professional man by providing more opportunity for him to become employed." We understand that many of the professions share our concern in this matter. Therefore, we believe something can and must be done to make self-employment as financially attractive as employee status. We also believe the enactment of this legislation would make the smaller communities of America better able to complete with the big cities for the services of physicians and other professional personnel.

With respect to this legislation under consideration, the American Medical Association believes that the bill reported by the Committee on Finance during the 86th Congress, as it applied to the self-employed and their employees, would be a notable addition to pension legislation. Inasmuch as the House-passed version of H.R. 10, 87th Congress is substantially similar we believe that it merits the support of the committee and the Senate.

May I also take this opportunity to thank you, Mr. Chairman, and the members of your committee for your activities in behalf of the self-employed and their employees.

Sincerely yours,

F. J. L. BLASINGAME,
Executive Vice President.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation has supported the general principles of this type of legislation for several years, within limits adequate to prevent abuse. The following resolution on this subject was adopted by the voting delegates at the 1960 annual meeting of this organization:

"Under present laws certain employer contributions to retirement plans are deductible by the employer and nontaxable to the employees. This discriminates against self-employed persons, who are required to pay taxes on any income that they set aside for retirement. In the interest of equity *we recommend that a self-employed person be permitted to deduct from gross income the amounts paids during the tax year to purchase a single premium annual life annuity, beginning at age 65, equal to not more than 1 percent of his earnings from self-employment during the year*, within limits adequate to prevent abuse. Annuity payments received under this plan should be fully taxable when received without exemption, deduction, or offset of any kind other than personal exemptions.

"We oppose efforts to give employees a tax deduction for payments to retirement plans where the benefits are nontaxable when received." [Emphasis added.]

You will note that we recommend a different approach in determining the maximum amounts that may be deducted annually from adjusted gross income by a self-employed taxpayer than is proposed in the legislation under consideration. This 1 percent of earnings plan was presented in detail by our general counsel, Allen Lauterbach, in his testimony before this committee on June 18, 1959.

You also will note that our policy resolution proposes to make annuity payments received under self-employment retirement plans "fully taxable when received without exemption, deduction, or offset of any kind other than personal exemptions." As passed by the House, H.R. 10 would make such retirement benefits subject to the retirement income credit.

In summary, we favor the principles of this legislation, but urge consideration of the differences in approach set forth above.

NATIONAL MILK PRODUCERS FEDERATION,
Washington D.C., July 24, 1961

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We shall greatly appreciate it if you will include in the hearing record on H.R. 10 this statement supporting the bill.

The National Milk Producers Federation is a national farm organization. It represents approximately half a million dairy farmers and some 800 dairy cooperative associations which they own and operate and through which they act together to process and market at cost the milk and and butterfat produced on their farms.

The lack of adequate provisions for the retirement income of dairy farmers is a matter about which we are deeply concerned.

Very important advances have been made in removing the fear of old age, and we have come a long way from the time when many of our older people were dependent on relatives or relief for their very existence in their declining years.

Social security is a basic step in providing for old age. Pension plans for employees supplement social security in a large part of the employment field.

Now we need to go further and set up a program which will encourage the self-employed to supplement social security with their own retirement programs. H.R. 10 is designed to provide such incentive.

We have given a great deal of thought to what might be done for dairy farmers in this field. The more we work on it, the more convinced we are that the first step should be legislation such as H.R. 10.

H.R. 10 would permit self-employed individuals to set aside a portion of income in productive years for use after retirement age, with a corresponding deferment of tax liability. We are hopeful that its enactment would focus attention on individual retirement plans and create a spark which would result in many people providing more adequately for their old age.

We believe the loss in current tax revenue would be far outweighed by the social and economic strength that would result from increased retirement savings.

We hope you will bear in mind, in your deliberations on this bill, the need of dairy farmers for a base on which they can build more adequately for their own retirement.

Sincerely,

E. M. NORTON, *Secretary.*

AMERICAN ASSOCIATION OF SMALL BUSINESS,
New Orleans, La., July 24, 1961.

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: You will recall that I met with you and a number of representatives of various businesses and professional organizations from the State of Virginia, in your office, last year. Just shortly after that meeting a Senate Finance Committee of the 86th Congress approved legislation which previously had been passed by the House, generally known as the Self-Employed Individuals Retirement Act.

Once again the Self-Employed Individuals Retirement Act is being considered by your committee. H.R. 10, passed by the House of Representatives, is similar to the legislation which has been approved by the House for many years. Each year in the past, however, it has died in the Senate.

I urgently request you again to do your utmost to see that H.R. 10, the Self-Employed Individuals Retirement Act, is approved by your committee promptly, so that it may be acted upon by the entire Senate.

The inequality of opportunity experienced by the self-employed, as compared with the pension provisions furnished the employee by the many segments of industry, has long created a hardship for the self-employed.

Your cooperation in seeing that this letter is placed on file in the record of the hearing on H.R. 10 will be very much appreciated.

I send all good wishes to you, and I want to take this opportunity to congratulate your organization upon its recent victory in the race for Governor of the State of Virginia.

Please let me hear from you at your earliest opportunity as to what you will be able to do, in accordance with my request.

Please remember me to my friends in your office and keep a great share of all good wishes for yourself.

Yours for keeping small business in business, and,

Very sincerely,

J. D. HENDERSON,
National Managing Director.

COMMERCE & INDUSTRY ASSOCIATION OF NEW YORK, INC.,
New York, N.Y., July 25, 1961.

Re H.R. 10, Keogh, approved.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We have been advised that your committee is holding a public hearing today on the indicated bill, which would permit a self-employed individual to make income tax deductible contributions to a qualified plan for

his retirement and to account for the benefits when received during the period of retirement. For the record Commerce & Industry Association reaffirms its approval of the measure.

This legislation would equalize to a modest extent the tax treatment of persons engaged in business and professions who do not operate as corporations, either because of legal prohibitions or from choice, with that accorded corporate employees (including officers). The bill would reduce existing discrimination against self-employed taxpayers.

Enactment of a bill such as the one being considered by your committee is long overdue. Not only would it grant a self-employed taxpayer the opportunity to provide for his retirement without reduction of his contributions by the amount of tax required to be paid but, in addition, the funds thus invested in qualified retirement plans would contribute to the economic stability of our country and provide an additional source of funds for use in our economy.

Commerce & Industry Association urges favorable action on the bill.

Sincerely,

RALPH C. GROSS, *General Manager.*

SHENANDOAH, IOWA, *July 25, 1961.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.:

Members of the Southwest District of Iowa Dental Association urge your support of Keogh bill, H.R. 10. Please include this wire in the record of the hearing.

D. DEAN RAY, D.D.S., *Secretary.*

STATEMENT BY PHILIP WILL, JR., FAIA, PRESIDENT, THE AMERICAN INSTITUTE OF ARCHITECTS

The American Institute of Architects again wishes to go on record in support of H.R. 10, the Self-Employed Individuals Retirement Act. With a membership of more than 14,000 registered architects assigned to chapters throughout the country, the institute represents the majority of the practicing architects in the Nation and is qualified to speak in behalf of the profession.

Over the years, institute representatives have appeared before Senate and House committees to urge adoption of this legislation. Most recently, in June 1959, Marcellus Wright, Jr., of Richmond, Va., urged the Senate Finance Committee to give favorable consideration to H.R. 10 "in the interest of equity with other taxpaying citizens." He concluded his statement with the plea, "We ask no gifts but only justice in means of income deferment for proper spread and balance."

We are aware that this committee reported the measure favorably in the last session of Congress, but unfortunately it did not come up for a vote prior to the end of the session. We therefore urge the committee to act promptly and again make a favorable report in the hope that the bill may go to the floor of the Senate and be considered at an early date.

In closing, we repeat that the architects of this country are not asking for special dispensation. They seek, along with many millions of other self-employed persons, only the same treatment given to employed persons who are granted tax deferment on a limited portion of their income set aside for retirement.

LOUISVILLE, KY., *July 25, 1961.*

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.:

The Kentucky Dental Association is on record as favoring the Keogh bill (H.R. 10). We urge your committee to take favorable action and request that this wire be included in the record of the hearing.

A. B. COXWELL, D.M.D.
Secretary-Treasurer, Kentucky Dental Association.

HACKENSACK, N.J., *July 25, 1961.*

Re H.R. 10.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Please be advised that I am strongly in favor of H.R. 10, the Keogh-Utt bill, which is presently under consideration by your committee.

It has been apparent for many years that in the income tax structure of our country few benefits are given the self-employed, and especially the professional people, which are in some form or other available to most of the other segments of our tax population.

In a nation that has built its strength on the initiative of the individual, this is, indeed, a poor state of affairs, and I urge your committee to act favorably on this legislation before you and the active support of all Senators in passing this bill this year.

I request that this communication be placed in the record of your committee hearings.

Very truly yours,

BIRGER M. SWEEN, *Counselor at Law.*

MORRISON, LLOYD & GRIGGS,
COUNSELORS AT LAW,
Hackensack, N.J., July 25, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I am associated with the above firm in the practice of law in Hackensack, N.J., and support H.R. 10, the Keogh-Utt bill, and wish that this communication be placed in the record of the hearing which I understand is to be commenced by your committee on July 25.

Yours very truly,

KEVIN M. O'HALLORAN.

WESTWOOD, N.J., *July 25, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We are most anxious to express our approval of H.R. 10, which we understand will be before your committee for a hearing within the next few days, and we respectfully ask that our letter be read into the record.

It is, unfortunately, impossible for either of us to attend the hearing in person.

Thanking you in advance for any consideration you may give this matter, we are,

Yours very truly,

BRATT & BRATT,
Counselors at Law,
By JOS. FREDERICK BRATT.

THE AMERICAN COLLEGE OF RADIOLOGY,
Chicago, Ill., July 21, 1961

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: The American College of Radiology is an organization composed of more than 5,000 doctors of medicine in the United States who specialize in the use of X-rays and radioactive substances in the diagnosis and treatment of disease and injury.

The American College of Radiology requests and urges that the Senate Committee on Finance approve H.R. 10, which will extend to the self-employed tax deferment opportunities now limited to corporate employees.

We believe that enactment of such a measure not only represents simply equity to this group of taxpayers, but is also in the public interest. The present tax laws prejudice young people of ability against entering many of the occupations in which self-employment is the rule. We refer to accounting, architecture, dentistry, law, medicine, and the like. The services of members of these occupational groups are personally important to all of the people of the United States to a degree far in excess of that indicated by the numbers in the groups. These are personal service occupations, professions. It is important to each one of us having relationships with these practitioners that they be individuals of high intellectual and moral caliber. We need good architects, dentists, lawyers, and other professionals. To perpetuate a tax system that comparatively penalizes this group is neither wise nor desirable. In terms of tax treatment, these occupations should be allowed to function in a manner that parallels other intellectually attractive occupations that normally exist within, or under, the corporate form of organization.

Further, the present denial of tax equity to these groups is leading to unprecedented State legislative efforts to permit them to use the corporate form in organizing to render services. The laws of nearly all of the States have heretofore recognized that the public interest would not be well served by allowing the professions to function under the impersonal corporate form with its accompanying ability to limit legal liability. Enactment of H.R. 10 would retard, or eliminate, this trend in State law and similarly the tendency in some professional men to seek corporate employment to obtain the tax advantages open to corporate employees.

The American College of Radiology has made no recommendations as to the precise provisions of legislation as is represented by H.R. 10. We are not tax experts. We do support the principle of tax equity embodied in H.R. 10 and urge that the committee recommend its enactment.

The college will appreciate your including this letter in the printed record of your current hearings on H.R. 10, Self-Employed Individuals Retirement Act.

Sincerely yours,

WILLIAM C. STRONACH, *Executive Director.*

STATEMENT OF SENATOR FRANK E. MOSS (DEMOCRAT, UTAH), SENATE FINANCE COMMITTEE, JULY 26, 1961

Mr. Chairman, I appreciate the privilege of filing a statement in support of H.R. 10, the Self-Employed Individuals Retirement Act of 1961.

Yesterday Mr. Stanley S. Surrey, Assistant Secretary of the Treasury, appeared before this distinguished committee. Although he stated that the administration opposes the bill, he said "The Treasury recognizes that present law does not give self-employed persons tax treatment for their retirement savings comparable to that now accorded to employees covered by employer-financed pension plans."

In view of this statement, I don't believe it is necessary for me or other proponents of this legislation to waste time discussing whether or not an inequity exists. The Treasury Department admits it. The question is whether we do anything about it now, or wait, as the Treasury Department recommends, until a later date.

The people of Utah are greatly interested in H.R. 10, and many of them representing an excellent cross section of the self-employed farm folks, small retailers, lawyers, dentists, doctors, and others have written me both in this Congress and the last one urging its enactment.

Naturally, they have given a lot of thought to their old age, and the vast majority of them say that they have nothing other than OASI to live on once they retire. They can't understand why they are being penalized because they are self-employed and do not work for a corporation. Gentlemen, with but few exceptions, these are the "average" people of my State, the middle-income group often referred to as the backbone of this great country of ours.

I am concerned about this inequity and I believe that the majority of our colleagues feel it is time to remedy it.

H.R. 10 was first introduced in 1951 and has been before the Congress for over 10 years. It has always had bipartisan support from Members who feel that enactment of the bill is the best way to deal with this unfair situation.

Mr. Surrey testified here yesterday that the Treasury Department fears H.R. 10 would create "new inequities and unjustified differences in tax treatment," and asked that action on the problem be deferred until it can be studied in perspective to the whole tax program in connection with the comprehensive tax reform adjustments the President has requested. Of course, no tax is ever entirely fair, and I do understand the administration's interest in submitting a well-rounded tax-adjustment program for consideration in one package.

However, if we pass this bill now, we will establish the principle of voluntary retirement plans for the self-employed, and by the time the Congress considers the overall tax program, inequities which have arisen can be ironed out in the general bill. I think the time has come to press H.R. 10 through the Congress.

Mr. Chairman, the people who want this bill are not asking local, State, or Federal governments to take care of them in their retired years. They are asking simply for a postponement of tax liability so that they may be able to set something aside for their old age. They are willing to put up the money when they are able to spare it from the demands of their business. All they are asking of us, the Congress of the United States, is that we offer them the same tax consideration that 18 million corporate employees are receiving, so that they can provide for themselves.

In my opinion, it is imperative that H.R. 10 be enacted now. The self-employed have already waited too long for a fair retirement plan.

Thanks for your courtesy.

AMERICAN SOCIETY OF CIVIL ENGINEERS,
New York, N.Y., July 24, 1961.

HON. HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This is addressed to you on behalf of the American Society of Civil Engineers to express endorsement of the principles embodied in H.R. 10, cited as the "Self-employed Individuals Tax Retirement Act of 1961." We are informed that a hearing on this legislation will be held by the Senate Committee on Finance on Tuesday, July 25, 1961.

ASCE is the national society for the profession of civil engineering in our country. It consists of 47,000 individual members, among whom are engineers in private consulting practice, engineers in high positions in industry, and employees of both private and governmental organizations.

We are convinced that the present system of income taxation imposes manifest inequity on "earned income" such as that derived from salaries, professional fees, and other forms of compensation for professional services. Self-employed persons, like others, must pay tax on their current incomes. In turn, they are required to pay tax on the income from such savings as they may be able to accumulate. The same is true of employees who are so situated that they do not have the advantages of private pension plans customarily made available by corporate employers.

The advantage to employees who participate in private plans is obvious. The employer places aside funds which are not taxable to the employee currently and no tax is required until the employee receives the benefit upon retirement. We believe it only fair that self-employed persons be granted some comparable opportunity to provide for retirement income.

The inequity of the present system is strikingly evident when the plight of self-employed professional people is contrasted with the situation of businessmen. One who operates an incorporated business enjoys a marked advantage. Such a man, assuming that his operations are successful, may take out of his business income enough to cover his personal needs and plough back the balance into his corporation. Although that balance is subject to corporate tax, the rate is substantially less than that on personal income. The net result is that such a business venture can expand and increase in value through the years. With increasing age, such a man may retire from active business life and enjoy the income from dividends on stock he has accumulated; he may ease his tax burden on dividends by giving some of his stock to members of his family; if he sells his business, profit so realized is subject to a maximum capital gain tax of 25 percent; upon his death, he may leave his going business concern to members of his family, thus providing for their future welfare.

By contrast, it is very difficult for an engineer, architect, lawyer, doctor, or any other person whose income is derived from personal services to set aside,

during his years of relatively high earning capacity, enough to provide adequate income for his declining years, to say nothing of providing for his family after his death. This is true whether an individual be operating as a professional man offering his services directly to the public or one who spends his professional life in salaried positions where no special retirement provisions may be available to him. In either case his earning capacity generally declines materially after passing a peak during middle age, and, unless he has been able to accumulate sufficient reserve to provide adequate income during his late years, his plight is sorry, indeed. While this is a situation of long standing, it has become seriously aggravated with the increases in income tax rates during recent years.

The situation of the individual practitioner is further aggravated by fluctuations in yearly income. It is almost inevitable that, while the income of such a person may be substantial during some one year, or brief period of years, it will suffer drastic decline in others. In case of illness his income may cease entirely. The result, of course, is that the individual practitioner, in the long run, is required to pay income taxes reaching a high total when compared to his total income throughout a period of years.

It is a generally accepted principle that taxes should be levied in proportion to the ability to pay. We are not here contesting this point. However, it seems only sensible and just to consider that the criterion for "ability to pay" should be established on some more reasonable basis with respect to lifelong ability. We consider that the provisions of H.R. 10 constitute an appropriate step in the right direction.

Respectfully submitted.

WILLIAM H. WISELY, *Executive Secretary.*

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS,
Washington, D.C., July 19, 1961.

Re H.R. 10.

HON. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In a spirit of fairness that pervades all legislative bodies, careful thought should be given to the iniquities that now exist between the self-employed taxpayers and the law that now exists in the favor of corporate employees. The bill would provide the self-employed a measure of encouragement to plan and lay away a part of their income during their working, productive years for the enjoyment, security, and livelihood of their retirement.

The present high taxes and inflated living costs make it difficult for self-employed to set aside money for retirement in the absence of tax deferments. It is true that, in many instances, qualified young men are going on a payroll rather than becoming self-employed.

H.R. 10, as the Treasury reported, would cause but little loss of tax revenues. The noble objectives of thrift and of being independent in later years should have the unqualified sanction of all.

Public accountants with modest incomes included in a professional group are strongly desirous of having the opportunity to put aside in escrow funds a small part of their annual earnings which would be tax deferred. This would put them on a similar basis with certain corporate employees who now avail themselves of this tax treatment for retirement purposes.

Cordially,

R. E. JENNISON, *Executive Director.*

MONTANA STATE DENTAL ASSOCIATION,
Billings, Mont., July 20, 1961.

HON. MIKE MANSFIELD,
Senate Office Building, Washington, D.C.

DEAR SENATOR MANSFIELD: We are sending you herewith a copy of a resolution adopted by the membership of this association at its regular annual meeting on May 3, 1957, in support of the Keogh bill which was considered by the 85th Congress but which was not adopted at that time by the Senate.

At each meeting of the membership of this association since 1957, motions to endorse this type of legislation have been unanimously adopted. The most

recent action of the membership of this association upon this proposal was taken during its annual business meeting in Great Falls on May 5, 1961, when the membership again voted to actively support passage of the Keogh bill (H.R. 10), during the present session of the U.S. Congress.

We sincerely hope that you will support passage of H.R. 10 during the hearings of the Senate Finance Committee and on the floor of the Senate. We shall appreciate it if you will request that this letter and the attached resolution be included in the record of the hearings of the Finance Committee.

Sincerely yours,

L. R. HEGLAND, *Executive Secretary.*

The following resolution was unanimously adopted by the membership of the Montana State Dental Association at its annual business meeting, May 3, 1957.

"Whereas, the Internal Revenue Code grants to corporate officials and employees substantial income tax savings on certain amounts contributed to a corporate pension or retirement program for the benefit of these officials and employees; and

"Whereas similar tax savings are not granted under the law to self-employed individuals in connection with amounts contributed by them to their private pension or retirement programs; and

"Whereas, legislation, popularly known as the Jenkins-Keogh bills, to correct this tax inequity and to encourage sound saving practices on the part of self-employed individuals has been before the Congress for the past 6 years; and

"Whereas, during this period the essential equity of the Jenkins-Keogh proposal has been proven by irrefutable evidence and has gained the endorsement of both political parties and of the President of the United States: Therefore, be it

"*Resolved*, That the executive council of the Montana State Dental Association support the principle of the Jenkins-Keogh proposal which would entitle self-employed individuals to realize tax savings on specified amounts contributed to voluntary pension or retirement programs comparable to the tax savings enjoyed by corporate officials and employees in connection with their pension or retirement programs; and be it further

"*Resolved*, That the executive council of the Montana State Dental Association urge the 87th Congress to enact this proposal into law and ask each member of the Montana congressional delegation to lend his leadership and influence in the Congress to the achievement of this objective at the earliest possible date."

Attest:

[SEAL]

RICHARD C. RITTER, D.D.S.,
Secretary-Treasurer.

AMERICAN FEDERATION OF LABOR AND
CONGRESS OF INDUSTRIAL ORGANIZATIONS,
Washington, D.C., July 25, 1961.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing to express the determined opposition of the AFL-CIO to the passage of H.R. 10, the Self-employed Individual's Retirement Act of 1961, and request that this statement be entered in the hearing record on this bill.

This proposed legislation has been before Congress on a number of different occasions. The proponents argue that self-employed individuals suffer serious inequities under present tax laws as compared to wage and salary workers because they do not receive any tax benefits for private retirement plans.

However, the bill before you, rather than correcting any inequities, would create new and extensive tax benefits for a relatively few individuals that far outweigh any meager tax advantages that are now available to some wage and salary workers.

I would like to list a comparison of the advantages granted to a self-employed person under H.R. 10 with the benefits now enjoyed by wage and salary workers.

1. Under H.R. 10, a self-employed person can make his own decision at any time when he wishes to receive the tax advantages of saving for his retirement. A wage and salary worker has to obtain such opportunities through the collective bargaining process or wait for his employer to grant him such opportunities.

2. Under H.R. 10, the self-employed person can set aside up to 10 percent of his earnings, or $2,500, whichever is smaller, each year. The tax benefits received by a wage or salary worker are much smaller than these amounts, and normally are about 4 to 6 percent. Moreover, in many cases, the wage and salary worker has to, himself, contribute from his taxable income toward his retirement.

3. Under H.R. 10, the definition of "self-employment income" includes both earnings and return on investment in the business; whereas, for a wage and salary worker, contributions are a proportion of earnings alone.

4. Under H.R. 10, a self-employed person who is an employer of three or fewer employees does not even have to provide a pension plan for them. He can enjoy the benefits of H.R. 10 without taking any step toward providing similar benefits for his own employees.

5. Finally, and most important, under H.R. 10, the self-employed person acquires a nonforfeitable right to the amounts which he has set aside. They belong to him, or to his estate alone, and he cannot be deprived of them. The wage and salary worker has to meet many strict requirements before he can ever obtain the amounts set aside for him. For example, he must maintain his employment in good standing with his employer; he must live to retirement age; and he must actually make the decision to retire before he can draw his retirement benefit. Even if he has certain vested rights under the private pension plan, these rights normally are not acquired until he reaches a certain age and has acquired a minimum number of years of service.

In addition to creating these inequities, the bill would represent the loss of substantial sums of money from the Federal Treasury. The estimated revenue loss is approximately $350 million in the first full year of operation.

There is no reason to feel that self-employed persons should be entitled to such a tax benefit merely for saving money for his retirement. Let me point out that self-employed individuals already receive many specific tax advantages. For example, their income is not subject to the withholding tax system as is the income of all employees. The withholding system has the effect of making certain that almost every single dollar of taxes levied on wages and salaries is fully paid to the Federal Government. On the other hand, the problem of assuring full payment of taxes by the self-employed individual is far more difficult. No withholding system can apply to his income. Official studies show that it is this group of taxpayers that is responsible for not reporting large sums of taxable income to the Federal Government. It has been estimated that approximately 30 percent of all self-employed income is not reported on income tax returns.

The President and the Secretary of the Treasury have indicated that the administration plans to suggest a comprehensive program of tax reform to the 2d session of the 87th Congress. We firmly believe that H.R. 10 should be rejected by your committee, and the issue of tax status of funds set aside for retirement and welfare purposes be reviewed in connection with a proposal for more comprehensive tax reform.

Sincerely yours,

ANDREW J. BIEMILLER,
Director, Department of Legislation.

NEW YORK COUNTY LAWYERS ASSOCIATION,
New York, N.Y., July 26, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
The Senate, Washington, D.C.

DEAR SENATOR BYRD: The Committee on Taxation of the New York County Lawyers' Association has considered and recommends to the Senate Committee on Finance that it report favorably the Self-Employed Individuals Tax Retirement Act of 1961 (H.R. 10). The act, as you know, is intended to encourage the establishment of voluntary pension plans by self-employed individuals. Its objectives of thrift and independence in retirement merit the wholehearted support of your committee.

Without intending in any way to affect our general recommendation for approval, one of the members of our committee has submitted certain specific comments on various portions of the proposed bill for your consideration.

1. Section 401(a)(10) to be added to the Internal Revenue Code by the proposed bill requires that all employees who have 3 years or more of service be covered if the owner-employee has more than three employees. This is in contrast with section 401(a)(3)(A) of the present code which permits the exclusion from a plan of employees whose service does not exceed 5 years, provided such exclusion does not result in a discriminatory plan. In the interest of uniformity and to keep distinctions among plans to a minimum, it is suggested that proposed section 401(a)(10) be deleted or amended to conform to the present statute.

2. Section 401(d)(3) to be added to the Internal Revenue Code by the proposed bill requires that the rights in a plan of employees with 3 years or more of service must be nonforfeitable if the plan is that of an owner-employee with more than three employees. In the interest of uniformity and to keep distinctions among plans to a minimum, it is suggested that section 401(d)(3) be deleted. Furthermore, immediate vesting tends to increase the cost of a plan.

3. Section 401(c)(3) to be added to the Internal Revenue Code by the proposed bill provides that the contribution with respect to an owner-employee is to be based upon self-employment earnings rather than solely upon earned income. Superficially it would appear that the provision is too liberal. However, it is extremely difficult to compute the amount of earned income derived by an individual or by a partnership from its trade or business. Any formula written into the statute would necessarily be arbitrary. It is believed that the limitation of $2,500 is sufficient to offset the liberality suggested by the use of self-employment earnings as a base for the contribution.

4. Many self-employed individuals use the cash rather than accrual basis of accounting. In such circumstances the self-employed individual would not be entitled to a deduction unless he makes the payment within the taxable year. On the other hand, before the end of the taxable year he probably will not have the data necessary to compute the amount of the payment. Accordingly, it is suggested that the deduction for contribution by a cash basis self-employed individual be allowed for the year with respect to which the contribution is made if payment is made within 75 days after the close of the taxable year.

Request is respectfully made that you consider the foregoing views and incorporate this communication in the record before your committee.

Respectfully submitted.

HARRY JANIN, *Chairman.*

TRI-COUNTY DENTAL SOCIETY,
July 26, 1961.

Senator HARRY F. BYRD,
Chairman of the Senate Finance Committee,
Washington, D.C.

DEAR SENATOR: Whereas the Tri-County Dental Society does not meet in the summer to carry on any form of business, it is imperative that I as secretary of this organization tender this letter to you as chairman of the Finance Committee on legislation considering the Keogh bill H.R. 10.

The general opinion of our society favors the passage of this bill. Please include this letter in the record of the hearings. Thank you.

Sincerely yours,

EDWARD D. ATWOOD, D.D.S., *Secretary*

STATEMENT BY LEO P. ROTH, PRESIDENT, THE NATIONAL LICENSED BEVERAGE ASSOCIATION

Mr. Chairman and members of the committee, This statement is presented on behalf of the membership of the National Licensed Beverage Association in support of H.R. 10, which would permit the establishment of voluntary pension plans by the self-employed. The members of our association number in excess of 40,000 and are proprietors of taverns, restaurants, bar-cafes, and small independently owned hotels in 28 States and the District of Columbia.

We recognize a definite tax inequity and discrimination toward the millions of self-employed persons of this country. Small businessmen are anxious to make provisions for their retirement. However, we are not permitted such benefits as are the 21 million corporate employees and some 6 million Federal

and State government employees. These groups enjoy the benefits of tax sheltered retirement plans and fringe benefits.

The House passed bill now being considered by this committee has the sentiment of our members. This bill would bring about uniformity to all groups of self-employed, regardless of location. Recent surveys reveal that retirement planning is practically non-existent among the self-employed. Of course, H.R. 10, if enacted into law, would not compel us to accept its benefits. However, given the opportunity, the tax saving inducement would invite participation.

Small businessmen are important to the economy of this country. Of necessity, they are usually self-reliant. They should be relieved of any fears of retirement.

There are approximately 50 million retirement programs in existence covering corporate groups. We do not complain of the legislation which permitted corporate pension plans. On the contrary, we consider them sound, advisable, and to be further encouraged. We only ask that some 10 million self-employed be accorded this same tax treatment.

We are satisfied that passage of H.R. 10 is in the public interest and therefore urge this committee to give it a favorable report.

WASHINGTON, *D.C., July 27, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: After carefully reading Assistant Secretary Surrey's statement of July 25 at your hearings on H.R. 10, it strikes me the Mr. Surrey made at least one good point—although he was careful to conceal it in bureaucratic verbiage.

His good point, as I see it, was that there are more problems to be dealt with as regards small, independent businessmen than there are with regard to us professional men: doctors, lawyers, engineers, consultants, and the like.

Must we professional men, then, wait until the Treasury figures out the answers to all the problems arising in the small business area until we get some sort of a tax "break" that would permit us to set aside a little for our old age?

You would indeed have the gratitude of every professional man in the country if you could let the Treasury wrestle with the small business problem for the time being, and let us professionals proceed to set aside some reasonable amount, temporarily tax-exempt, for a personal pension fund. Since the great majority of us have one or, at most, two employees, we would be happy to make a comparable arrangement for them.

I would appreciate the inclusion of this letter in the record of your hearings.

Sincerely yours,

JOSEPH L. MILLER.

LOGAN & LOGAN,
COUNSELORS AT LAW,
Englewood, N.J., July 27, 1961.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I wish to have this letter included in the record in connection with H.R. 10 now before your committee for hearing. It is my opinion that legislation similar to the Keogh-Utt bill is long overdue. Legislation of this type will serve to remove a long-standing inequity in our tax structure and will, as you are well aware, serve to put partners and sole proprietors on the same footing with those able to incorporate and take advantage of the retirement provisions available to corporate employees. There is a growing tendency toward bigness in our business community and legislation of this type would serve to act as an incentive to the small businessman to continue to serve the community on the personal level to which he alone is suited.

Respectfully yours,

WILLIAM E. LOGAN.

STATEMENT OF NATIONAL LIVESTOCK TAX COMMITTEE

On August 11, 1959, G. Norman Winder, a member of our National Livestock Tax Committee, testified upon its behalf in favor of the Self-Employed Individuals Retirement Act. Since that time, we have suffered an unfortunate loss from death of Mr. Winder, but our interest and the interest of our sponsors in this legislation has remained very active. As Norman Winder pointed out 2 years ago, nearly one-half of all the sole proprietorships in the United States involve agriculture. Of these, most are concerned to some extent with livestock, and many are stockmen belonging to the organizations which sponsor our National Livestock Tax Committee. Thus, we are well aware, and wish to emphasize to the Finance Committee, that retirement legislation for the self-employed is by no means of concern only to doctors, lawyers, other professional people, and a few businessmen.

The livestock industry is peculiarly subject to violent depressions in prices which are not matched by corresponding reductions in its proportionately high fixed costs. Few livestock producers have reasonable incomes, maintained year in and year out. Most of them make practically nothing or lose money in their poor years, and can set aside retirement funds only in the good years. There is a need for these livestock producers, the great majority, to be able to set aside a portion of the profits of the good years, without having a major share virtually confiscated by high taxes.

H.R. 10, which is before this Finance Committee, is somewhat different from the bill previously supported by our National Livestock Tax Committee in 1959. It is also somewhat different from the bill reported favorably to the Senate floor in 1960. We would like the Finance Committee to refer to our 1959 statement mentioned above, and in addition, we would like to touch briefly upon what our members believe to be the most important changes which appear in the present bill.

In 1960, the U.S. Treasury Department presented a counterproposal to the bill then already passed by the House of Representatives and being considered by the Senate Finance Committee, the bill on which we testified in 1959. The Treasury stated as a major proposition that it did not want self-employed individuals to be placed in a substantially more favorable position than persons employed by corporations. (The fact that self-employed persons have for years been in a less favorable position was not emphasized in the Treasury's presentation.)

Acting upon the Treasury's recommendations, the Senate Finance Committee incorporated many of the suggestions made by it. The most fundamental proposal was that any self-employed individual wishing to set aside money for his own retirement would have to set aside a proportionate sum for each of his employees, if any. If, for example, 5 percent of his own income was to be set aside, he would also have to set aside 5 percent of his employees' income as well. This would not be a matter of the farm and ranch employees setting aside 5 percent of their own income as their employer would of his, but it would be an additional benefit to the employees financed by the self-employed owners of the ranches and farms where they work. The farmer or rancher in order to set aside 5 percent of his own earnings would have in effect, to increase the wages of his employees by 5 percent. This would be quite a price for him to pay for an opportunity to set aside his earnings. It would, in fact, create a discrimination against the self-employed person as compared to his employees. A truly nondiscriminatory provision would permit the employees of self-employed persons to set aside their own money at their own option for their own retirements, so that they would be on an equal footing with their employers.

Under the Treasury proposal, all employees employed 3 years or more on a full-time basis must be covered by a plan benefiting the employer and their benefits would vest immediately. These rules compare quite unfavorably with the rules governing corporate plans, which permit a waiting period of 5 years and gradual vesting of benefits. We are disappointed, therefore, that these provisions appear in H.R. 10; as now passed by the House of Representatives and presented to your committee (the scope of the vesting provision has even been broadened), except that they apply only when there are more than three employees.

As mentioned above, the income of self-employed stockmen varies greatly from year to year. Such employers cannot expect to contribute a percentage of their employee payroll, year after year. Yet the establishment of a plan which would qualify under the bill would have the result of creating an expectation among employees which it would be difficult to disappoint. Under these circumstances, many livestock producers would be discouraged from adopting any plan at all.

If employees are to be included, we approve of the limitation in the bill forcing inclusion of employees only if there are more than three. We believe, however, that the waiting period should be the same as under corporate plans—5 years. We believe also that the immediately vesting provision is unwise. The self-employed person should not be forced to deposit a stake for his employees to withdraw as severance pay when they decide to drift on to other jobs. This could actually encourage terminations and make a plan a drawback for the employer. The corporate employer, through gradual vesting, is permitted to encourage his employees to stay in their jobs, and the resulting stability and long training in skills is in the national interest no matter who the employer may be. In the case of agriculture, the difficulties in retaining employees are even greater than in most business endeavors. There is no reason for stricter requirements with respect to self-employment plans than with respect to corporate plan. Nor should this problem be approached by the correction of real or imagined defects in present laws relating to corporations. The problem at issue is not the correction of "inequities" with respect to corporate plans, but rather the development of reasonable legislation for the self-employed.

In summary, we believe that the requirements of H.R. 10 are more onerous for self-employers than in the typical corporate case. Nevertheless, we would support any bill such as H.R. 10 which obviates in part the complete discrimination against self-employed persons which exists at present. It is a step in the right direction. With respect to the bill now before you, we would prefer that the requirement of extending the plan to employees at the employers' expense be eliminated, or modified so as to permit extension to employees only at their options and at their expense. If such provision is not eliminated or so modified then, we strongly urge retention of a breaking point of at least three employees (preferably more), a change to 5 years of full-time employment before an employee must be brought in, and adoption of the present corporate rules concerning vesting of contributions.

A second major change made in the Senate Finance Committee last year related to the definition of self-employment income. The original definition, now restored to the bill, followed the definition for self-employment tax purposes. This makes sense and is equitable. Contrary to the Treasury's implication in its letter of April 1, 1960, to your committee, the definition does not include "investment income" as that term is ordinarily used.

The source of the 1960 Treasury proposal was the definition of earned income in the section (sec. 911 I.R.C. 1954) defining "earned income from sources without the United States." The complications inherent in forcing a rancher to add to his present calculations of income for Federal income tax purposes, and income for self-employment tax purposes, a new category—income for retirement deduction purposes—are so obvious as not to require much elaboration. We support the definition now appearing in the bill.

In conclusion, we feel that H.R. 10 as presently before you, provides a measure of relief for self-employed persons, which is very desirable, though it is still less favorable (particularly with respect to persons with highly fluctuating agricultural incomes) than the relief afforded corporate employers. We would strongly oppose, moreover, any further weakening amendments which may be urged by the Treasury.

NATIONAL LIVESTOCK TAX COMMITTEE,
By ALBERT K. MITCHELL, *Chairman.*
STEPHAN H. HART, *Attorney.*

WHEELING DISTRICT DENTAL SOCIETY,
Wheeling, W. Va., July 29, 1961.

Senator HARRY F. BYRD,
Chairman, Senator Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Members of the Wheeling District Dental Society are in favor of the Keogh bill (H.R. 10) and urge your support in this matter.

Will you please include this letter in the record of the hearings.

Sincerely,

WILLIAM R. GRUBLER, D.D.S., *Secretary.*

RENO, NEV., *July 27, 1961.*

Hon. HARRY F. BYRD,
Chairman of the Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The Washoe County Bar Association wishes to state its support of H.R. 10 and requests that this letter be included as a part of the hearing record.

As we are well aware that you and your committee are thoroughly familiar with the provisions of this bill and the desirability of its enactment, we shall not detail the reasons for our support.

An excellent expression of the necessity of legislation of this sort, at least insofar as it affects the legal profession, may be found in the article by Congressman Eugene Keogh which appears in the July issue of the American Bar Association Journal as the lead article.

Thank you for your consideration.

Very truly yours,

WASHOE COUNTY BAR ASSOCIATION,
By ROBERT TAYLOR ADAMS, *President.*

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10 a.m., Friday, July 28, 1961.)

SELF-EMPLOYED INDIVIDUALS' RETIREMENT ACT

FRIDAY, JULY 28, 1961

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:15 a.m., in room 2221, New Senate Office Building, Hon. Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Long, Smathers, Anderson, Douglas, Gore, Carlson, Bennett, and Morton.

Also present: Elizabeth B. Springer, chief clerk; Russell M. Oram, technical adviser, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The bill before the committee is H.R. 10.

The Chair recognizes Senator Carlson.

Senator CARLSON. Mr. Chairman, the distinguished junior Senator from Kentucky, Mr. Thruston B. Morton, was here before the opening of the session and had to leave for a meeting of the Commerce Committee. And he asked me to read for the record a statement that he had prepared to give himself.

STATEMENT OF HON. THRUSTON B. MORTON, A U.S. SENATOR FROM THE STATE OF KENTUCKY, AS PRESENTED BY HON. FRANK CARLSON, A U.S. SENATOR FROM THE STATE OF KANSAS

Senator CARLSON. "H.R. 10 is an intelligent, well-conceived piece of legislation that should be enacted by the 87th Congress.

"I was a Member of the House when this legislation was first introduced in 1951 and I consider it most unfortunate that 10 years later we are still trying to pass this meritorious measure.

"After considerable research I introduced S. 841 in the 86th Congress, a bill identical in every respect to the then H.R. 10. The reason for doing so was to attract the attention of my colleagues on the Finance Committee, since I feel that this legislation corrects a grave injustice in our tax laws.

"It is an accepted fact that one of the big inducements which corporations offer our trained young men and women is an attractive pension plan. Now, I have nothing against the large corporations. I cannot blame them for recruiting the bright young brains of America, but I do think it is important to the future of this country that a certain number of these smart young men and women strike out for themselves.

"It is not right that a self-employed individual should have to relinquish his private practice and gain employment with a corporation

or the Government in order to receive the benefit that I believe he should receive under the law. I believe that he is entitled to this benefit as a self-employed farmer, small business, or professional man.

"We are not pioneers in this field of legislation, but merely following the good example of Great Britain, Canada, and New Zealand, where legislation similar to H.R. 10 has been adopted. In this connection, I should like to point out to those who oppose H.R. 10 because of the revenue deferral that the actual deferral in these countries was far, far below the original estimate.

"In view of their experience and data presented during the course of last year's hearings, I believe the actual revenue deferral will fall considerably short of the Treasury Department estimate.

"It will be argued during these hearings that action should be postponed until a general tax revision occurs, but I believe the inequity to the self-employed to be so glaring that it should be corrected without further delay.

"It is illogical for the Treasury Department representatives to oppose this legislation because the revenue loss is too great when they are almost daily approving tax-deferred employee pension plans involving millions of dollars in revenue loss.

"The courageous self-employed people of the great State of Kentucky and the United States are vitally interested in this remedial legislation and I intend to diligently seek the enactment of H.R. 10."

I thank you, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Chairman, I have heard with interest the statement of my distinguished colleague from Kentucky. Every Member of the Senate and every citizen has a right to his views. I do not question that right.

But I wish to call to the committee's attention that Senator Morton, like every other person who has undertaken to justify the special privilege which would be granted by the enactment of H.R. 10, has sought to justify this privilege because of the corporate pension plan provisions of the law. He did not cite the abuses of corporate plans; he cited the availability and the attractiveness of them as justification for H.R. 10.

I read in the New York Times this morning that Mr. Colbert has resigned as president of Chrysler Motors. The article reported that he would have retirement benefits of approximately $92,000 per year.

Now, if the Congress remains idle or supine, if the tax-writing committees of the two branches of the Congress continue to close their eyes and do nothing to protect the stockholders of American corporations, do nothing to limit the excesses of corporate insiders, then not only will such an inequitable measure as H.R. 10 be advanced as a result, but so will many others.

The President abjured all American citizens to ask not what the Government could do for them, but what they could do for the Government. In response to a great challenge and greatly increased expenditures, on Tuesday night the President called upon the Congress to provide additional revenue by closing loopholes of tax favoritism.

The first response of our committee is to hold a hearing on a bill to create another loophole. I think it is very unfortunate.

The CHAIRMAN. The Chair has been asked to supply for the record statements from the American Dental Association, the American Bar Association, as well as the Junior Bar Conference of the American Bar Association, and the American Institute of Certified Public Accountants.

(The material referred to follows:)

STATEMENT OF THE AMERICAN DENTAL ASSOCIATION, JULY 27, 1961

ASSOCIATION'S OFFICIAL POSITION

The American Dental Association in 1948 authorized its council on legislation to support Federal legislation directed toward removing income tax inequities imposed upon self-employed groups. Again, in 1954, the association emphatically endorsed the principle contained in H.R. 10 as indicated by the following resolution adopted in that year:

"*Resolved*, That the council on legislation be authorized to seek, or support, legislation which, if enacted, will offer to dentists an opportunity to establish a retirement income plan or fund for themselves as individuals under the same tax equities as are now provided for the beneficiaries of company sponsored plans" (Transactions, ADA, 1954:263).

The American Dental Association believes strongly that the considerations which led Congress to enact the legislation permitting tax deferments on funds paid into qualified pension plans by employers for the benefit of their employees apply with equal force to the legislation that is before this committee to accord the same tax treatment for similar arrangements made by the self-employed.

There would appear to be no sound reason for encouraging the establishment of pension plans for the employees of business organizations without providing the same encouragement for the establishment of plans for those who employ themselves.

It should be noted that with the country's general advances in living standards, in health care and in the health sciences, the people are living longer, the segment of the population over age 65 is increasing at a constant rate. This trend will continue and will continue to pose serious problems. Many agencies, both public and private, currently are giving increased attention to these problems and are attempting to devise means of meeting them. In light of this, it would seem prudent and logical to act now to encourage additional people to provide for themselves the security they will need after they have reached retirement age and have lost all or part of their earning power. The substantial number of self-employed people in this country can be given this encouragement through enactment of the retirement incentive plan embodied in H.R. 10.

It is believed that it would be wholly desirable to take this approach in inducing people to obtain for themselves the financial security they will need for their old age.

IMPORTANCE OF H.R. 10 TO DENTISTS

Approximately 80 percent of the practicing dentists in this country are self-employed. The dental profession, therefore, is greatly affected by those tax policies which discriminate against self-employed persons, particularly the professional practitioner who is a sole proprietor or member of a small partnership. The substantial majority of dentists in this country practice in one of those two ways.

A problem common to most individuals is that of providing a source of income for their later years related to the standard of living set during more productive years. A solution to this problem is not only in the individual's interest but in the interest of our economy as well. Congress has recognized the objective as a worthy one through its enactment of the provisions now contained in sections 401–404 of the Internal Revenue Code of 1954 which provide for the establishment of employee pension plans. The tax benefits in these sections, however, are preferential in that they apply only to employed persons.

The economic difficulties faced by a self-employed dentist in providing for his later years are in many respects more complex than those encountered by employed persons. The dentist starts on his professional career relatively

late in his youth after spending approximately 6 to 8 years in preprofessional and professional study. Thus, the typical dentist is almost 27 years of age when he first enters dental practice and begins to earn income, and he has expended many thousands of dollars in securing this education.

After he has completed his education and started his practice, the dentist's most economically productive years are also the years when his business and family costs are at their peak. At the very outset of his career he must make a very substantial investment in equipment and supplies; the cost of establishing a dental practice ranges from $5,000 to $15,000 and is met ordinarily by a term financing arrangement which is amortized over the years. These and other costs are, of course, coincident with the high personal living expenses incurred initially in rearing a family, purchasing a home and acquiring the other necessities of life. It is during this period also, when he is relatively young, that the dentist can most advantageously inaugurate a retirement program but it also is the period when it is most difficult economically for him to do so. After he is established, the dentist has not a great many years of high income productivity, after which his earning power diminishes significantly. This cycle of dental income is demonstrated in a study made by the association's bureau of economic research and statistics in 1959, utilizing income figures for 1958 which shows that during the years of his greatest financial obligations, from age 35 to 54, the dentist reaches his peak earning capacity. After age 54, his net income diminishes markedly.

If this cycle is viewed against the many financial responsibilities, both professional and personal, faced by a dentist over the course of his career, it can be seen that he has little opportunity under the present tax program to esatblish a suitable retirement program. Typically, the dentist is seldom encouraged at any stage of his career to allocate funds regularly for his later years. The tax incentives contained in H.R. 10 would enable the self-employed dentist, as sections 401–404 of the existing code have enabled the employed person, to provide adequately for retirement years.

THE SELF-EMPLOYED GROUPS

Experience has shown that the tax policies of the Federal Government can and do accomplish more than the production of needed revenue. Indirectly the taxing policy may encourage the institution or expansion of desirable social measures; the favorable tax treatment of so-called fringe benefits for employed groups is a noteworthy instance. The pension contribution advantages for employed persons under existing law, for example, are being highlighted at this hearing.

Unquestionably the favorable tax treatment of employed groups in the area of fringe benefits was considered a wholesome social and economic step. It might now be appropriate to consider whether the status of self-employed groups should be enhanced in the national interest.

It is believed to be in the best interest of the public that learned professions remain predominantly a self-employed group. The dentist, the physician, the lawyer offer highly personalized services. The typical professional practitioner is devoted first to the interests, the welfare of his patients or clients; his service to them is much more than a job to be done. These and many other characteristics of professional endeavor can best be preserved through the so-called private practice system. Whether the private practice system for professional endeavor continues to attract persons with the needed qualifications and skills may be a critical question in the near future. This Nation needs engineers, scientists and teachers. Almost invariably their functions are performed as employees. In the future a great deal of effort will be spent to attract the top students to these pursuits; this is vital to our national interest. But is from the same class of students that dentistry and medicine must draw their future practitioners.

This committee might well reflect upon the growing difficulty that is foreseen in attracting young, capable people to the self-employed professions. For example, the number of candidates applying for admission to dental schools has been declining at a rate that is beginning to cause concern. There were 6,119 applicants for the 1960 dental class compared with 6,498 in 1959. While this decline has not yet resulted in a decrease in the quality of accepted dental students it might have this result if the downward trend continues.

It is believed that one of the reasons for this apparent trend away from selection of one or the other of the self-employed professions as a career is the

economic uncertainty involved. There is, of course, no way of determining in advance whether a dentist, for example, establishing his practice, will have sufficient patients to assure him a reasonable income. In some instances he will not, and will have to relocate his practice. Most salaried persons on the other hand not only may be assured a definite income while they are working, but usually the company by which they are employed has a plan for income after retirement.

The combination of employment security and the many inducements that are being initiated to attract students to engineering, science, and teaching will unquestionably have an effect upon the recruitment of qualified persons to dentistry and other professional endeavors. The American Dental Association does not, of course, expect this committee to resolve this problem completely. The association does urge the committee to consider the enactment of H.R. 10 not only as a desirable measure to equalize the tax treatment of the self-employed with the employed group, but also as an effective step toward preserving a strong and vital force of self-employed professional practitioners in the national interest.

The American Dental Association is a charter member of the American Thrift Assembly and supports the assembly's position on this legislation.

STATEMENT OF WILLIAM REECE SMITH, JR., CHAIRMAN, FOR THE JUNIOR BAR CONFERENCE, AMERICAN BAR ASSOCIATION

My name is William Reece Smith, Jr. I am an attorney engaged in the private practice of law as a member of the firm of Mabry, Reaves, Carlton, Fields & Ward, Tampa, Fla.

I am chairman of the junior bar conference of the American Bar Association and am privileged to submit this statement at the request of the junior bar conference and in its behalf.

The junior bar conference is an organization of more than 27,000 young lawyers under the age of 37, and is composed of a very good cross-section of all the younger lawyers in the entire country.

The vast majority of the membership in the junior bar conference is self-employed in private practice of the law; consequently its interest in H.R. 10 and similar legislative proposals is very real and direct.

Let me say here that the junior bar conference strongly urges the passage of H.R. 10 because we believe it will tend to alleviate discrimination in present Federal tax laws against pension plans for the self-employed. For at least each of the past 3 years the junior bar conference at its annual meetings has adopted resolutions favoring the passages of similar proposals. I am attaching to this statement a copy of resolution No. 11 pertaining to this area which was adopted without dissent by the delegates to the junior bar conference at its annual meeting in August 1960 at Washington, D.C.

There seems to be a more or less widespread belief that the private practice of law is an automatic road to early, continuing, and substantial financial success. Nothing could be farther from the truth. Mr. Ross L. Malone, a former president of the American Bar Association in testimony on similar legislation, pointed out to this committee[1] that lawyers in private practice do not reach their maximum earning potential until about the age of 50 years—until they have endured a starvation period while they progress on the professional ladder through many years of study and experience. In the earlier years of practice, some lawyers will be unable to take advantage of the tax deferment provisions, if enacted. But all of us look forward to the years to come when we hope to be in a position to set aside some savings for eventual retirement under the plan of H.R. 10.

Too often there are those who overlook the fact that in addition to being a profession which imposes the highest degree of fidelity, the private practice of law is also a business form which is relied upon for livelihood. But because of its nature, it is a calling which must be conducted under restrictions which are not imposed upon the overwhelming majority. As you know, because of the nature of our profession, private practitioners generally may not adopt the corporate form of business organization. Denied to us therefore are the tax

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[1] Hearings before the Committee on Finance, U.S. Senate, on H.R. 10, June 17, 1959, pp. 69, 70.

saving advantages permitted the employees of a corporation. But it does not follow that the individual need of a lawyer in private practice to provide for old age is less than that of others simply because the lawyer is self-employed. This is self-evident.

The number of lawyers in private practice and new law graduates entering this field in proportion to those entering industry is decreasing each year, although our overall population steadily increases. And make no mistake about it: a corporate pension plan is one of the most compelling arguments inducing lawyers to enter corporate service. As chairman of the junior bar conference, I have been made acutely aware of this fact from personal experience. This legislation, then, would permit an added counterincentive against the corporate pension plans and other fringe benefits which today are so attractive to young people.

Obviously this is not to suggest that the private practitioner is about to become an extinct breed, for he is not. I would not be presumptious enough to remind you gentlemen that private practice of the law is a bulwark of freedom. From their beginnings the traditions of our country have found their most eloquent expression through the arts of the dedicated private practitioner. Indeed, the liberties we enjoy would not be possible without him. Private practice thus gives an inward satisfaction produced by few other endeavors, and in a very real sense therefore provides its own reward. It is for this reason that lawyers unhesitatingly give much of their time and talent when there is little hope of financial return. For this reason, too, lawyers consider it their duty to represent indigent defendants who are accused of crime and to take positions of leadership in the civic and political life of every community. But in these perilous times of the struggle for the minds of men, the private practice of law should be strengthened and encouraged—not discouraged and weakened because tax incentives are not available to it on substantially the same terms which are extended by law to other business forms.

We believe this is good tax legislation. It corrects an inequity now favoring corporate employees. The legislation does not provide for tax evasion, but it does permit tax deferment. The funds accumulated do not lie sterile, but are pumped back into the economy by the various custodial institutions. In addition, in our case, it provides a needed incentive to sustain the growth of an important segment of the legal profession and of the community—the independent self-employed lawyer.

Thank you.

RESOLUTION NO. 11[1]

Whereas present Federal tax laws providing for retirement benefits programs discriminate against the self-employed; and

Whereas the American Bar Association and the Junior Bar Conference of the American Bar Association are presently engaged in active support of H.R. 10 to remedy this discrimination: Therefore be it

Resolved, That the Junior Bar Conference reiterate its support of H.R. 10 and urge the House of Delegates of the American Bar Association and upon the Members of the Congress of the United States favorable consideration and enactment at the earliest possible time; be it further

Resolved, That the Junior Bar Conference section delegate in the house of delegates be, and he is hereby requested, to make the substance of this resolution known to the house and to cast his vote in accordance therewith.

STATEMENT OF WHITNEY NORTH SEYMOUR, PRESIDENT, AMERICAN BAR ASSOCIATION, JULY 25, 1961

My name is Whitney North Seymour, I am president of the American Bar Association, which is composed of appproximately 100,000 members. The American Bar Association and practically every State and local bar association have for many years sought the enactment of legislation to permit farmers, owners of small businesses, professional persons, and other self-employed individuals to participate in voluntary tax-deferred retirement plans. Existing law confines its benefits to so-called employee pension plans, thus automatically excluding the self-employed but including stockholder-employees of corporations.

[1] Adopted at annual meeting of the Junior Bar Conference, August 1960, at Washington, D.C.

LEGISLATIVE HISTORY

Legislation seeking to eliminate this discrimination against the self-employed was overwhelmingly passed by the House of Representatives in the 85th and 86th Congresses, and again in this Congress. Extensive hearings were held by the Senate Finance Committee in 1959 and a modified version of H.R. 10 was approved by this committee by a vote of 12 to 5. Unfortunately, however, it was not voted on by the Senate. The House-passed bill which is now before you is based largely on the Finance Committee bill of last session.

In 1942, the Congress adopted the policy of offering substantial tax benefits to employers and their employees in connection with the establishment of voluntary pension plans supplementing social security. Since the self-employed could not qualify as "employees," the result of the legislation was to deny them an opportunity to provide for their old age and the resultant loss of earning power through a tax-deferred pension plan.

In 1945, a movement began to obtain legislation authorizing restricted retirement programs for those not eligible for or covered by employee pension plans. In 1950, the American Bar Association appointed a committee to study the problem. This study resulted in the drafting of proposed legislation which was introduced in 1951 by Congressmen Keogh and Reed of New York. Since its original introduction, this proposed legislation has had strong bipartisan support in Congress and widespread support throughout the country. Over the years the bill has undergone many changes in form and substance but its underlying purpose has always been to achieve for the self-employed a measure of equality in the tax treatment of voluntary private retirement plans.

The present bill is the result of years of study and consideration and represents a composite of the views of the House of Representatives, the Senate Finance Committee, and the Treasury Department on the subject.

EFFECTS OF THE INEQUITY

The fact that an inequity exists in the present tax law, which gives preferential tax treatment only to pension plans set up by employers for the benefit of their employees, is generally recognized. The Treasury Department freely admits the tax discrimination against self-employed persons. The House Ways and Means Committee, the House of Represenţives, and the Committee on Finance of the U.S. Senate have all recognized the existence of this inequity. It is difficult to understand why after 19 years such an obvious discrimination in our tax laws is allowed to remain.

Certainly the present exclusion of the self-employed was not intended for the purpose of discouraging the carrying on of one's profession or occupation as a self-employed individual or of forcing the self-employed to carry on a business in corporate form or as employees of corporations. Yet, this is precisely the situation that is tending to result from the failure of the Congress to correct this existing discrimination against the millions of self-employed persons.

That there is a definite trend away from the professions into corporate and Government employment, due in a large part to the retirement advantages and other so-called fringe benefits made available, is evidenced by the fact that there are now more than three times the number of salaried lawyers in private employment in the United States than there were 10 years ago. The most recent census of the legal profession completed by Martindale-Hubbell, Inc. shows that although the total number of lawyers has increased by 23,683 from 1958 to 1961, the increase of those engaged in private practice has been only 3,398.

Without some tax deferral for retirement savings, adequate savings for old age by the self-employed is virtually impossible because of the high income tax rates now in effect. The practicing lawyer, for example, has a peak earning period of 20 years, generally between 45 and 65 years of age. He has reached that stage by first going through a period of lean years. During those 20 years he must put away enough to take care of his old age. He has no depreciation or depletion deductions and he cannot amortize the cost of acquiring his skill. The result is that, after he pays his taxes and the high cost of living, it is difficult if not impossible to lay away anything for his old age.

REVENUE DEFERRAL

A major concern to those who have opposed this legislation has been the deferment of tax revenue to the Treasury. Conflicting testimony has been given

to this committee as to the estimated amount of revenue involved. But, regardless of the precise amount, we should not lose sight of the fact that the potential revenue loss under the bill is already made possible in the present tax law since the establishment of tax-deferred pension plans is available to any self-employed person who incorporates his business or occupation. We do not believe that the Members of Congress deem it desirable to force incorporation of farms and small businesses, nor to require professional persons to seek some type of corporate association in order to avail themselves of the same tax treatment with respect to their retirement savings as is enjoyed by the millions of persons covered by qualified pension plans.

OPPOSITION TO PROPOSAL LIMITING DEDUCTION TO 50 PERCENT

There has been a proposal before this committee to limit the self-employed person's deductible amount to one-half the amount actually contributed, subject to an overall limitation on his contribution. Such a limitation would go a long way to kill off any incentive many self-employed persons otherwise would have to set up a pension plan for themselves and their employees. Certainly the bill would then be of little incentive to those self-employed persons in the lower income brackets. This proposal seemingly is motivated by the fact that under the civil service retirement system, which is on a contributory basis, Federal employees receive no deduction on their own contributions and thus benefit from tax deferment only on the contribution made on their behalf by the Government. This is the same tax treatment that is given private contributory plans. But the trend in private enterprise is toward noncontributory plans as evidenced by the fact that $6 of every $7 put into private qualified retirement funds are contributed by the employer. In other words, 85 percent of the funds are paid by the employer and are not currently taxable to the employee.

The other contention made to support the 50 percent deduction limit is equally unsound. It is argued that since the social security system is financed by a tax of which half is paid by the employee and half by the employer, the self-employed individual, being his own employer and employee, should only be allowed a deductible contribution of one-half of the amount that he invests in a private plan. But this contention loses sight of the fact that nearly everyone, including the self-employed, is covered by social security and that this system has no relation to the establishment of supplementary private retirement plans. It may also be pointed out that although the employee's contribution to social security is not tax deductible, the entire social security benefits when received are tax-free to the recipient. The same procedure applies to the railroad retirement system.

RECOMMENDED ACTION

H.R. 10 as passed by the House of Representatives generally adopts the approach approved by this committee last year. It differs from the Senate Finance Committee's version in that it pertains solely to the problem of correcting the inequity against the self-employed and does not include proposed changes in corporate pension plans covering so-called owner-employees. Such proposed changes should be considered as separate legislation after careful study. The obvious and long-existing inequity regarding the self-employed should be considered by Congress on its own merits without interjection of other controversial matters. For 10 years, Treasury spokesmen have recommended that the correction of the discrimination against the self-employed be deferred until general tax revision. Yet the Treasury has never submitted a proposal to correct the inequity, which it admits exists.

In addition to correcting a longstanding inequity, the legislation before this committee is in the national interest in that it encourages thrift and self-reliance by encouraging the self-employed to provide for their own retirement and not be dependent on Government assistance in their old age. We urge the members of the Senate Finance Committee to pass H.R. 10 and thus afford the millions of self-employed persons the opportunity to provide for their retirement years.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
New York, N.Y., July 27, 1961.

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: The Committee on Federal Taxation of the American Institute of Certified Public Accountants has reviewed H.R. 10 as passed by the House on June 5, 1961, and recommends that your committee act favorably on the measure.

H.R. 10, a bill designed to encourage the establishment of voluntary pension plans by self-employed individuals, is similar in principle to bills which have been introduced in Congress over the past decade. The Committee on Federal Taxation believes that the objectives of H.R. 10 are sound and would eliminate the inequities now present in the Internal Revenue Code with respect to the availability of tax-encouraged retirement plans. Present law permits a corporation with a qualified pension plan to deduct its contributions on behalf of its employees, including controlling stockholder-managers. There is no comparable provision for encouraging the self-employed person to provide for himself.

On other occasions, the institute has endorsed the principle of legislation which would assist self-employed individuals to establish retirement plans. At a recent meeting, our council, the governing body of the 40,000-member institute of certified public accountants, endorsed in principle the legislation embodied in H.R. 10. At this time we convey the council's endorsement and respectfully recommend that your committee favorably report H.R. 10.

After careful consideration of H.R. 10, the Committee on Federal Taxation has concluded that the proposed legislation is very well drawn and should be workable. There are some provisions, however, which we feel require more attention. Attached for your consideration is a technical memorandum on these provisions. We hope our letter and memorandum will be included in the record of the hearings.

We would be pleased to amplify our comments and suggestions, and to assist your committee and its staff in any way possible.

Respectfully submitted.

LESLIE MILLS,
Chairman, Committee on Federal Taxation.
HERMAN STUETZER, Jr.,
Chairman, Subcommittee on Special Tax Problems.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, COMMITTEE ON FEDERAL TAXATION, TECHNICAL MEMORANDUM ON H.R. 10

This memorandum accompanies the letter of the committee on Federal taxation recommending that the Committee on Finance favorably report H.R. 10.

1. PROPOSED SECTION 401(a)(8)(B)

Under this provision an unmarried employee cannot provide for a dependent relative. The bill should be changed so that it will provide for distributions over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a dependent of his.

Proposed section 401(a)(8)(B) requires that a qualified plan must provide that the entire interest of each employee will either be distributed to him not later than the year of his retirement or will be distributed over either the life or the life expectancy of the employee or of the employee and his spouse. This provision appears to discriminate against unmarried employees. Such employees would be deprived of any method of providing through the pension or profit-sharing plan for the security of dependent relatives in the event of their premature death following retirement. If such an employee elected payments over his own life expectancy and reached that life expectancy, payments would then cease, leaving him unprotected. If he were to die shortly before attaining such life expectancy only a small remainder would be provided for the relative. In the alternative if the employee were to elect payments over his own life, the relative would be left without resources upon his death at any time following retirement.

Under existing law, it appears that the relative could be protected under a joint and survivor annuity in the same manner as the spouse. No restriction upon such treatment appears to exist under present law or in any of the Treasury regulations or published rulings.

It is noteworthy that in the case of owner-employees for whom more stringent rules are provided, proposed section 501(d)(7) would permit life annuities to beneficiaries in the event that distribution over life expectancy had been elected and the employee died before the life expectancy was attained (or both the employee and his spouse died, if distribution over the life expectancies of both was elected).

2. PROPOSED SECTION 401(e)(2)(C)

It is not clear when the Secretary or his delegate is to mail notice that an excess contribution has been made.

It is proposed that the notice required to be given by the Secretary or his delegate to the person for whom an excess contribution has been paid shall not be mailed prior to the time that the amount of tax of the owner-employee for the taxable year in which such excess contribution was made "has been finally determined." This phrase should be defined or reference made to other parts of the Code which state what this means.

3. PROPOSED SECTION 404(a)(8)

Section 404(a)(6) of present law provides that a contribution must be paid under a plan within the taxable year to be deducted in that year unless the taxpayer is on the accrual basis. The proposals in the bill for the self-employed individuals will apply to a group of taxpayers who generally are on the cash basis. Such proposals will not be workable unless cash basis taxpayers are treated the same as accrual basis taxpayers in this regard.

Present law allows an accrual basis taxpayer to claim a deduction for contributions to qualified plans made subsequent to the taxable year to which they apply provided they are paid before the due date of the return including extensions thereof. Cash basis taxpayers must make payment within the year to which the contribution relates in order to obtain a deduction. Cash or accrual basis taxpayers should be treated the same in this regard since it is not always possible to determine the amount of the allowable contribution before the end of a taxable year, particularly in the case of profit-sharing plans and where self-employment earnings are a factor. An owner-employee on the cash basis may not be able to determine the contributions which he must make within the taxable year because of insufficient facts available to him at year end. In view of the restrictive "excess contributions" provisions and the absence of "carryover" provisions similar to section 404(d) of present law it is essential that a cash basis taxpayer be permitted the same treatment as an accrual basis taxpayer with respect to the time within which a contribution must be made under a plan to be deductible in a particular year.

4. PROPOSED SECTION 172(d)(4)(D)

It is proposed that deductions for contributions to a plan for a self-employed individual will not be treated as attributable to the trade or business of such individual for the purpose of computing a net operating loss deduction. No such provision exists under present law. It appears that deduction for such contributions should be allowed to self-employed individuals as a cost incurred in the trade or business.

It is proposed that any deduction for contributions made on behalf of a self-employed individual under a qualified employees' plan shall not be treated as attributable to the trade or business of such individual for the purposes of computing a net operating loss deduction. Since contributions under a qualified employees' plan directly relate entirely to the trade or business, it seems reasonable that the deduction should be allowed as a deduction of the trade or business even if part of a net operating loss.

Senator GORE. And I would like to submit for the record a telegram I received from the Tennessee Veterinary Medical Association.

The CHAIRMAN. Without objection the insertion will be made.

(The telegram referred to follows:)

KNOXVILLE, TENN., *July 25, 1961.*

Hon. ALBERT GORE,
U.S. Senate, Washington, D.C.:

H.R. 10 (Keogh bill), Self-Employed Individual Retirement Act will be heard by your committee July 25, 1961. The membership of the Tennessee Veterinary Medical Association has stated the Association approves and supports this bill. We request your aid and cooperation on this urgently needed tax equalization. Will you present to this office your position on this bill as soon as possible? I request that this message be made a part of the record.

Sincerely,

TENNESSEE VETERINARY MEDICAL ASSOCIATION,
DR. H. W. HAYES, *Secretary and Treasurer.*

The CHAIRMAN. The committee this morning has as the first witness a distinguished Member of Congress, of the House of Representatives. He has been before the committee a number of times.

And we welcome you, Congressman Keogh. You have introduced H.R. 10 how many times?

STATEMENT OF HON. EUGENE J. KEOGH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. KEOGH. This is the sixth time it has been introduced.

The CHAIRMAN. How did you get a monopoly on that number?

Mr. KEOGH. Well, I expect it is the gracious consideration of the Speaker on the convening of the Congress. And I have always thought that his graciousness was predicated upon the fact that it is much easier for Members of Congress to remember one number than to have it changed from Congress to Congress.

Senator BENNETT. Could the Speaker remember one number?

Mr. KEOGH. I think the Speaker would probably remember all numbers, but it is just for the other less adequate Members.

Senator GORE. Mr. Chairman, from my association with the distinguished Congressman and others of his colleagues in the House, I know that this courtesy on the part of the Speaker results from the love, esteem, and respect in which Congressman Keogh is held by the Speaker and all his colleagues.

Mr. KEOGH. Thank you very much.

The CHAIRMAN. Mr. Keogh, we are very happy to have you here, and you may proceed.

Mr. KEOGH. I would be perfectly willing to trade those very nice remarks on the part of the Senator from Tennessee for a little more passivity on his part with respect to the bill.

Senator GORE. All that is needed to pass this bill is a little passivity. And I am not inclined in that way.

Mr. KEOGH. Mr. Chairman, I appreciate the opportunity to make this brief, and I trust final, biennial appearance before your distinguished committee in support of the pending bill, H.R. 10, and to thank you, Mr. Chairman, most sincerely for having scheduled this hearing.

My task this morning is rendered the simpler for the reason that I follow Secretary Surrey's testimony of Tuesday, and I shall be followed by the testimony of Dr. Roger Murray, of Columbia University.

If anything could be said with respect to the Secretary's testimony of Tuesday, I should be inclined to limit my observation to the fact that in my opinion he made a fairly factual and accurate recitation of the provisions of the pending bill.

With respect to his opinions, whether contained in his direct statement or in response to the interrogatories, I shall make no comment other than to rest with the general scope of the remarks that I am going to make this morning.

To make your task perhaps a bit easier, we have incorporated in the pending bill most of the provisions affecting the self-employed that were contained in the bill reported by your committee in the last Congress. The differences are neither great nor irreconcilable.

Reference was made on Tuesday to the so-called Long amendment, on which we have expressed ourselves in the past. Our views with respect to that have not changed. And while we think the amendment not essential, if your committee should adopt it, I personally would be in favor of it, and I trust so would any conferees appointed on the part of the House.

The CHAIRMAN. Would you explain the Long amendment?

Mr. KEOGH. Senator Long, as I gather it, suggests that we should adopt as a basic theory of this bill that the contributions made by the self-employed for themselves and their employees should be accorded a deferment only up to the extent of 50 percent of that contribution.

My position on that, Mr. Chairman, is that it is in the nature of an anticipatory defense. It is seeking to lessen if not destroy any possible claims on the part of those who presently are members of public or private retirement systems in which the employee must make contributions.

My point in that regard, Mr. Chairman, is that, in the field of the qualified pension plan, the trend is obviously and admittedly in the direction of being noncontributory on the part of the employees.

The last full years' figures that I have had made available to me show that, in 1957, there were $3,700 million contributed by the corporate and other employers of this country into qualified Treasury-approved private pension plans, and in that same year, the millions of employees covered contributed only $800 million, showing that the trend is in the direction of removing the contributions on the part of the employees.

A similar trend, Mr. Chairman, has been instituted in the field of public retirement systems. The State of New York and several cities have begun a process of absorbing the contributions heretofore made by the their employees.

The CHAIRMAN. Do I understand it that under the Long amendment a contribution made by the employer would be deductible only to the extent of 50 percent of his income taxes?

Mr. KEOGH. That is my understanding of the suggested Long amendment, Mr. Chairman.

The CHAIRMAN. To what extent would that reduce the loss, so-called, in the bill?

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Mr. KEOGH. I have had no accurate estimates given to me along those lines. But I think it would be fair to assume that if only 50 percent of the contributions were to be tax deferred, there would obviously be a lessening effect momentarily upon the revenues of the Treasury.

I do think that the form that the Long amendment took in the committee's bill last Congress provided for the 50 percent deferment, but at the same time provided for higher limits than the pending bill provides.

So I would suggest that perhaps in the final analysis the effect on the revenues would be very slight, if any.

The CHAIRMAN. I do not understand that.

If the employer contributes $100 to the pension fund, and then can only deduct $50 from his income taxes——

Mr. KEOGH. But you might recall, Mr. Chairman, that the form the Long amendment took, as I understand it, was that it raised the limits of the contribution to twice what we have provided, and accorded its deferment on half. So that you are back to the $100, to use your illustration.

The CHAIRMAN. Senator Long is not here yet; I assume he will be here before we conclude. He told me that it would reduce the loss to the Treasury by more than one-half.

Maybe you and I do not agree on all the details.

Mr. KEOGH. It is obvious that we would be in closer agreement if the limits in the pending bill were retained, and the deferment accorded only to half of the contributions. But if you doubled the limits in this bill——

The CHAIRMAN. Would you favor this bill retaining the present limits with the Long amendment?

Mr. KEOGH. Well, frankly, Mr. Chairman, I would prefer to see a rise in the present limits contained in the pending bill, if the Long amendment were adopted.

The CHAIRMAN. But in order to avoid the loss of revenue which has been discussed a great deal, would you be willing to accept the Long amendment with the present method of contribution; in other words, not increase the amount?

Mr. KEOGH. I hope, Mr. Chairman, you might be satisfied at the moment if I were to say that I would be inclined to be favorable to that suggestion. But I should like to plead surprise with respect to the proposal and seek a little time to give it further consideration.

The CHAIRMAN. You agree that that would be a very definite reduction in the loss as compared to the present bill?

Mr. KEOGH. Yes, I do agree to that, Mr. Chairman.

The CHAIRMAN. I do not see why it should not be one-half.

Mr. KEOGH. And I agree that it would also be a considerable lessening of the potential that the average self-employed could set aside in order to provide for superannuation.

But let me make this statement as a general proposition, Mr. Chairman. I am from New York. We engage, in New York, constantly in much trading and negotiating. I like to think that I also assume a very reasonable attitude with respect to offers that are made in settlement of differences.

The CHAIRMAN. If I may interrupt you, Senator Long is now here.

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Senator Long, we are discussing your amendment.

Mr. KEOGH. And may I for the edification of our great Senator from Louisiana repeat to him that I have expressed as my personal opinion my disposition to be inclined to support the Long amendment, and have expressed as my further opinion the fact that I think that any conferees appointed on the part of the House would hold to a similar attitude.

Senator LONG. I am happy to hear that.

Frankly, as you know, I started out being against your bill. But over a period of time I became convinced that there is a discrimination against doctors, for example, who are not in position to do what corporate owners-mangers can do; they do not have a retirement plan like we voted for ourselves. And I think almost any citizen has a right to demand the benefit of tax uniformity.

Now, I think it comes with poor grace for me as a Senator to vote for retirement plan in which I contribute 6 precent and the Government 6 and then deny the doctor the right to have a deduction for the part that could be compared to the employer's portion. If one is both the employer and the employee, he puts up both parts. So the half that his employer would put up if he were employed should properly be deferred if we are going to defer it for ourselves.

So it seems to me that we ought to be willing to treat doctors and lawyers and others on the same basis as we treat ourselves; we should not treat them any less favorably than we are willing to treat ourselves. And I think we ought to treat them as fairly as Government employees and persons under social security. And my amendment would seek to carry out that concept. And I would support the bill if that were in it.

Mr. KEOGH. It would carry out the concept, Senator Long, but while you were necessarily detained I pointed out to the committee that in the field of the qualified pension plan, the trend is obviously and admittedly in the direction of being noncontributory on the part of the employee. That trend has also been inaugurated and instituted in the field of public retirement systems.

The State of New York, for example, has inaugurated a step-by-step program that will eventually result in the absorption by the State of the share of that public retirement system now paid for by the employee. Reference was made the other day and the Congress seemed to have been chided slightly for not having moved pending legislation to exempt the contributions made by the railroad employees to their retirement system.

I know I need not point out to the members of this committee that that very system, the railroad retirement system, is a system where the employees' contributions are matched by the employers, taken by the employers as a business deduction, and the annuities received by the individuals are, under the Railroad Retirement Act, completely exempt from taxes.

So that if you were to take the final step and permit the deduction by those employees of their share, you would have the obviously unique and, in my opinion, unprecedented situation of a retirement system for a relatively small group of people which is completely exempt from taxes on the paying in and on the receiving out; it is unheard of.

Senator LONG. In fairness, what we should do is to draw a bill on retirement that seeks to arrive at uniformity. And I think that everybody should be willing to agree with that.

Have it so each citizen is entitled to demand the right to be treated as well as his neighbor.

Mr. KEOGH. I understand that, Senator. And I intended later in my remarks to make reference to the observation of Secretary Surrey, that while the Treasury Department recognizes the existence of a problem, they have no positive solution for it.

That reminds me of the often made remark that patients very frequently die while the specialists ponder the remedies.

Senator LONG. It does seem that the Treasury should be able to think up the answer to the thing after they have been studying the problem for 6 years.

Mr. KEOGH. Eleven years.

Senator LONG. They had six to my knowledge. I have had 6 years to think about it, and I came up with what I think we should look for.

But the thing that concerns me is that every time we have come up with a computation of what it would take if we made all these retirement systems fully deductible for both the employee contribution and the employer contribution, and if you gave other private citizens the right to do the same thing on their own behalf, such as farmers and others, we have always been confronted with a fantastic revenue loss, oh, $3 or $4 billion, if everybody took full advantage of the same principle.

That being the case, it seems to me that we could say all right, instead of moving toward everybody getting the full deduction, why should we not move toward everybody getting half the deduction.

I put up 6 percent as a Senator and I am matched by 6 percent from the Government. That is in effect the Government paying me $1,850 on which I am deferring taxes on an annual basis until after I retire. And only after I get back what I have already put in myself, and then I am proceeding to use the interest and the Government payment on that portion, only then do I start paying a tax on what has been put aside for my retirement.

Now, in fairness, I would be willing to vote for a doctor to have the same thing that I have for myself.

Mr. KEOGH. Senator, I am obviously avoiding being drawn into a discussion of the congressional retirement system. What you have said with respect to the percentage of contribution by the employee and by the employing agency of government is correct. But it is not a full statement of that retirement system.

But again I say, I do not want to be drawn into a comparison of any existing plan. I am simply here appealing for 9 million Americans who, under our law, by the omission of the Congress, have no right to do anything to help themselves in their superannuation, a negation of the very basic theory and principle upon which social security is predicated, upon which section 165 of the 1939 code was enacted and reenacted as section 401 of the 1950 code.

Reference has been made here that this is no time to take any revenue from the Treasury.

Mr. Chairman, I need remind you only that section 165 under which the thousands of qualified plans, all approved by the Treasury, now costing upward of $4 billion a year, covering 20 million people, was enacted in 1941. And I do not recall, having then had the honor to be a Member of the House of Representatives, that that was a particularly good year as far as Treasury revenues were concerned.

And since 1941, Mr. Chairman, the existence of Treausry deficits has been the custom and not the rule. So it seems to me that it comes rather surprisingly that when we have a proposal to benefit 9 million people now excluded at a cost of $358 million—and you and I know as practical men that the Treasury never underestimates the effect of the proposals it opposes—I am impatient with one who raises the question of the effects of this pending bill on the revenues of the United States.

Senator LONG. Let me ask you this.

In all probability, if we did what I am advocating here, and if my amendment came through, would that not in effect cut the revenue loss to one-half or perhaps one-quarter of what the estimated revenue loss would otherwise be?

Mr. KEOGH. We were talking about that before you arrived, Senator. And my idea on that would be that if your amendment were adopted, your committee should give serious consideration to raising the limits in the bill.

Senator LONG. Well, if a person could set aside up to a total of $2,500 with 15 percent being the other limit on how much could be set aside, rather than 10 percent, then a person could still get a $2,500 deduction, but he would have to put aside $5,000 in order to do that.

If a person is making, let's say, $25,000, he would find it somewhat difficult to find $5,000 that he could set aside.

Mr. KEOGH. Unfortunately, a colloquy was had on this aspect of it on Tuesday—unfortunately, neither you nor I nor the Congress can insure that every self-employed person in this country will make the maximum that one can make. All we can do is to give to all of them an equal opportunity.

The fact of the matter is that the imposition of this dollar limit in the bill will affect such a small minority of the self-employed that it is ridiculous in my opinion to address ourselves to it. The effective maximum for upward of 86 percent of the self-employed in this country will be the percentage. And the imposition of a dollar maximum in addition to that percentage is simply imposing a penalty upon those relatively few who, by good fortune or by capability, earn in self-employed income upward of $25,000.

But I am perfectly willing to go along with that kind of limitation.

Let me point out to you, Mr. Chairman, and to the committee, discussion was had on the question of predicating the contributions on the base of self-employed income. Here we are faced again with another instance of the vacillating position taken by the Treasury Department.

An earlier form of the bill predicated the contributions on earned income, and the Treasury opposed it, and opposed it on the ground that the reporting of self-employed income for social security purposes would faciliate the administration of the contributions made hereunder.

So we change it back to the self-employment base, and they come in and oppose it, for the reason that it is not the earned income.

The original form of the bill included not only the self-employed and their employees, but all the pensionless employed in the country. And the Treasury opposed it. And we then came back with a form of the bill reluctantly, somewhat reluctantly, but justifiably, eliminating the pensionless employed, and the Treasury Department opposed the form of that bill because we eliminated them.

This, in face of the fact that the proposal has been pending for 11 years, and not once has the Treasury Department come forward with a positive suggestion of how the admitted injustice, the grave problem as they have described it, would be solved.

The CHAIRMAN. Did not the Treasury approve the bill passed out by the Senate Finance Committee last year?

Mr. KEOGH. Mr. Chairman, I have never been faced with the necessity of determining whether that was positive approval or whether it was just passive acceptance. But my point with respect to that, Mr. Chairman——

Senator GORE. A reluctant acquiescence.

Mr. KEOGH. Well, I hope that I may persuade the distinguished Senator from Tennessee to adopt a similar attitude.

The CHAIRMAN. I think they did approve it, Mr. Congressman. David Lindsay, representing the Treasury, approved the bill that the Senate Finance Committee passed out last year.

Mr. KEOGH. Well, with reference to that I rest on this simple statement, that the pending bill does not—and I strongly think should not—include any provisions intruding in the field of section 401 generally, or owner-managed corporate plans particularly.

Such changes, if any, should be proposed by those who think such changes are needed, and they should stand or fall on their own merits or lack of them.

Now, Mr. Chairman, I was asked the other day to give a parliamentary history of the bill. I shall do it briefly. The first form of what might be described as a reasonably identifiable predecessor of the pending bill was introduced in the 82d Congress in 1951. Public hearings were held by the Committee on Ways and Means in that Congress on May 13 of 1952. Thereafter the bill was reintroduced in the 83d Congress and in the 84th Congress. And public hearings were held by the Committee on Ways and Means on June 27 and 28, 1955.

There was also testimony received in public hearings by the Committee on Ways and Means on H.R. 10 in the general revenue revisions in 1958. The Committee on Ways and Means received testimony in panel discussions on income tax revision in 1959, on November 16, 17, 18, 19, 20, 23, 24, 30, December 1, 2, 3, 4, 7, 8, 9, 10, 11, 14, 15, 16, 17, and 18.

In addition to that, Mr. Chairman, H.R. 10 was orderd reported by the Committee on Ways and Means four times, has passed the House three times, each under a suspension of the rules requiring a two-thirds vote.

I submit, Mr. Chairman, that a recitation of that history would indicate to me that the necessity for any further hearings on the

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subject, whether in this body or in the House, is open to some reasonable question, I should say.

Now, Mr. Chairman, if I may, I would like briefly to refer to some of the statements made by the Secretary of the Treasury.

Senator LONG. If I might just interrupt you at that point, I am one of those who does not really think that the House ought to try to tell the Senate, or the Senate ought to try to tell the House, whether they should conduct hearings or should not conduct hearings. I think if the House wants to pass a bill, they ought to be permitted to pass it however it feels like passing it. And I think it should be understood that when a bill comes over here, it is our privilege to do anything we want to do, throw it in the trash basket, pass it, or do whatever we please with it.

Mr. KEOGH. I agree with your principle in that regard, and I am not going to characterize the action of this committee in the last Congress, nor do I want to characterize in any way the care and consideration that will be given this bill by your committee in this Congress.

I am simply resting on the recitation of the parliamentary history of the legislation. And I think that any reasonable man reading that would indicate that this is not a matter that has been flippantly or insufficiently considered.

The CHAIRMAN. I think you ought to compliment the committee for the fact that we reported the bill at the last session, and it was a rider on the Virgin Islands bill, and Senator Douglas said it had ceased to be a virgin.

Mr. KEOGH. If I may be permitted briefly to go off the record, Mr. Chairman——

Senator DOUGLAS. Put it on the record.

Senator GORE. Mr. Chairman, I have been duly chastened for my indication of surprise that the other committee did not have hearings on this bill this year. I am sorry I made such a reference. It would have been better had I not done so.

I was surprised. Nevertheless, the distinguished Congressman has pointed out, and it is a fact, that there must be comity between the Houses, and this committee should not cast aspersions upon the acts of discretion or indiscretion of the corresponding committee of the other body. And if any offense has been taken, I certainly am sorry for it.

Mr. KEOGH. Mr. Chairman, I frequently act without express authority, and I will therefore now, on behalf of the House of Representatives, of which I am pleased to be a Member, accept the apology of the Senator from Tennessee.

Mr. Chairman, I would like now as briefly as I can to refer to some of the statements contained in the formal presentation of Secretary Surrey. And I would like to start out by reminding the committee that in the very first paragraph of his statement he makes this statement:

> The problem with which this bill is concerned, how to treat the retirement savings of the self-employed for tax purposes, is an important one.

Now, in the light of that concession, I would like quickly to run through and point out to you that, when he criticizes us for using the self-employed income as a base, I touched upon that earlier in my re-

marks. We had used the earned income in a prior bill, and the Treasury objected to it, objected to it on the ground that the reporting of self-employment income for social security purposes would facilitate the administration of the contributions made under that then form of the bill.

So we go back to the self-employment income base, and they come here and make objections to it.

He says:

Recognizing that the present law does not give self-employed people tax treatment for their retirement savings comparable to that now accorded to the employers covered by employer-financed pension plans, however, H.R. 10 as passed by the House does not provide a satisfactory solution.

Nothing has been satisfactory to the Treasury Department for 11 years. How long, Oh Lord, do we have to wait?

Senator GORE. You are treading upon the prerogatives of my former colleague from Tennessee.

Senator BENNETT. I thought he was referring to a still higher authority.

Mr. KEOGH. And in the colloquy on Tuesday, reference was made to the professional corporate form. Well, there is a trend in that direction, Mr. Chairman. But, unfortunately, at the rate the trend seems to be extending, it will not only be limited in scope among the several States, but it will be further limited by the restrictions as to which of the self-employed can so indulge themselves.

But there is another point which in my opinion destroys the argument that the extension of the corporate form to the self-employed removes the necessity of this bill.

How can those who here contend that existing law, section 401, gives to the corporate form far more advantages than they should have, argue that that form should be extended to the self-employed, when the pending bill has undertaken far greater than section 401 ever was purported to, to protect the revenues of the United States, to make certain that there would be compulsory payouts of the annuities created, that they would be included in the income tax returns of the individuals, that they would be denied the retirement income credit accorded everybody else in the country?

It seems rather inconsistent for one who opposes the pending bill to argue for the form of which he is more highly critical.

And a very pertinent observation, I think, here can be made, that with respect to existing qualified plans, they have all had to receive the approval of the Treasury Department.

If the Treasury Department is lacking in legislative or other authority to police those plans and to prevent abuses, it is incumbent upon it, in my opinion, to come to the Congress with legislative recommendations, but not to use that as a reason why these people should be denied anything.

It struck me, Mr. Chairman, with the greatest surprise, that in his statement Secretary Surrey seemed to take the position that H.R. 10 was unfavorable to the self-employed because of the limitations contained therein. We did that deliberately. We want to be reasonable about it. We want something, and we thought that if we got 10 percent or $2,500 with the recognition that that dollar maximum will apply to a woeful minority of those covered, that we would be starting somewhere, and not hindered forever.

Much was discussed the other day about multiple memberships in 401 plans. Obviously it is not possible, as Senator Bennett so well brought out the other day, for a self-employed individual whose limitation is his self-employment income, to distribute that among any number of plans. His contribution is limited to that base.

Now, Mr. Chairman, I would like briefly to mention the fact that reference was made to—or criticism was made of—the provision applying the bill to those self-employed with more than three employees who have 3 years or more of service.

We did that, Mr. Chairman, only to reduce the administrative problems in this area. We are not wedded to "three." But we eliminated the part-time and the seasonal employee. We thought that by imposing a minimum length of service we would be getting far more stability and order in the administration of the act. But if this committee in its wisdom sees fit to modify either one of those two conditions, I should not receive that with any fear or concern.

Senator LONG. Let me ask you this.

That so-called three-person requirement to set the plan up was put in in an attempt to more or less restrict the use of this proposal, was it not, restrict the use and reduce the cost of it?

Mr. KEOGH. It should have that effect.

But actually, we put it in simply to reduce the administrative problems, which would follow from the fact that fewer employers would utilize the plan.

Senator LONG. Frankly, it seems to me that if the amendment I have been urging were adopted, insofar as reducing the cost and providing uniformity is concerned, that would meet those two problems, and you would not need to have the three-man requirement.

Mr. KEOGH. I am not quarreling. I am perfectly willing to await the act of this committee in that regard.

Personally, I subscribe to the theory that if the principle is right, there should be no arbitrary conditions that might exclude any of those who are entitled to exercise the privilege.

Senator LONG. If a doctor has a nurse working in his office, that nurse is having the benefit of social security protection right now. If he has a secretary in his office, the same is true.

Now, in a few years that social security tax will be 10 percent. And that employee will be enjoying the benefit of a 5 percent contribution, which is not immediately taxable, and which is matched by a withholding on the part of the employer of the other 5 percent on which the employer is paying personal income taxes.

Now, if you applied the same principle to the doctor who is not under social security, logically he could certainly claim the right to set aside up to 10 percent on a basis which would be half-deferred and half not deferred. And I do not see that it should be necessary to take the nurse into the same plan with him when the nurse is already covered by social security.

Mr. KEOGH. Except this, Senator: It has always been my theory—it is not my theory, but it has been my opinion, and I know I am supported in it—that social security was never intended to be in lieu of qualified pension plans. Social security was always intended only to be a subsistence layer of retirement benefits that could and should be supplemented by other forms of retirement annuity.

Now, I simply do not want to be complicated by a discussion of social security, because you and I know that everybody in gainful occupations today is covered by social security except the doctors, the Federal employees, and those clergymen who have elected to remain out.

The self-employed pay social security taxes which are not deductible by them, to 150 percent of what the individual pays. They are being penalized to an extent in that regard.

It might be argued that nobody is making up the one-half now paid by the employers. But that is because they are in a unique, admittedly unique, position, which has been recognized by the legislature; they are neither employees, nor are they employers. And that is why we are here pleading for this bill.

If they were employees, they would have no case. If they were employers, they would have the right under existing law.

I would like, Mr. Chairman, if I may, having concluded briefly my observations with respect to what I thought were misleading statements of the Secretary—unintentionally misleading, of course—but in support of the general proposition that the Treasury Department has taken——

Senator LONG. If I might just make one other point there.

It would be true in many cases that a lot of these employees of self-employed people really might not be in the least bit interested in being a part of the retirement plan anyway, in many instances they might just prefer to have the money rather than the pension plan, they might need it more now than they would need it later on.

Mr. KEOGH. That may very well be. But at least they should have the right to be if they want to. And we have denied them the right, and have refused to give it to them.

Mr. Chairman, reference was made on Tuesday to a gap in the reported income of the classes affected by the pending bill. Unfortunately, there are instances of unreported income. But my point in that regard is that the enactment of this bill would have in my opinion the tendency to cause the self-employed taking the benefits under this bill to report with greater accuracy his income for income tax purposes.

So instead of having that used as an argument against the bill, it should in my opinion be one of the strong arguments in its favor.

Reference was made to tax increases on Tuesday. My reaction then and now was that any tax increases fall on the self-employed just as much as on any other taxpayer in the country.

Criticism was directed to tax-free accumulations provided by the bill. Tax-free accumulations are certainly not unique and certainly not without precedent.

We have given this careful thought over a long period of time. And we think that we have exposed it to limitations that are perhaps arbitrary, but we are willing to do it to make progress.

Now, reference was made to the public retirement system of the U.S. Government. I am not here referring to the congressional retirement system, but to the public retirement system, the U.S. civil service retirement system, into which the employee pays 6½ percent of salary, and against which the employing agency of government is charged in its annual budget with 6½ percent. The benefit scale

under the existing public retirement system of the United States is in the neighborhood of 21 percent. The individual employee, then, is the tax-free beneficiary of tax dollars, not 52-cent dollars, to about three times his own contribution.

Mr. Chairman, it would be rather difficult for me to feel that that individual would be harshly treated if these self-employed were accorded this right that we ask for them, not for the Government to take care of them, but for themselves to take care of themselves. That is all they want.

Senator DOUGLAS. Congressman, did I understand you to say that the Government contribution under the civil service retirement is not 6½ percent but 21 percent?

Mr. KEOGH. No, I did not say that——

Senator DOUGLAS. What did you mean by this 21 percent?

Mr. KEOGH. The present scale of benfits that have been enacted by the Congress of the United States is approximately, I am told, about 21 percent of payroll.

Senator DOUGLAS. Does this mean that the system is actuarially insolvent?

Mr. KEOGH. I am not taking any position on that, if you do not mind, because——

Senator DOUGLAS. I know. But I guess the Federal contributions have not been made in recent years, have they?

Mr. KEOGH. I understand there is some question about that. But if you do not mind—and I would be delighted to discuss it with you privately—I would prefer at this public hearing not to develop that too fully.

Senator DOUGLAS. You brought it up, Congressman, and I was curious. But even if the Government contributions were made—and I think they were not made in most of the years of the preceding administration—that would give you only 13 percent.

Are you saying, then, that the contributions, if made, will be 8 percent less than the amount needed to provide the benefits in the future?

Mr. KEOGH. No, I am saying—what I am trying to say, as obtusely as possible—I am trying to say——

Senator DOUGLAS. You should never be obtuse.

Mr. KEOGH. In this case I want to be, because of the psychological factors that enter into a discussion of this kind—that the Congress is faced with the problem of doing one of two things. And you and I have some idea of the one that it will not do, and that is to charge the employees and the employing agencies of Government for the benefits that the Congress has voted, or else you must charge the general funds of the Treasury for the difference, general funds into which the self-employed of this country make their proportionate contribution and out of which they get nothing.

Senator BENNETT. Mr. Keogh, I have been listening to this discussion. On the one hand we are talking about contributions of 6½ percent each.

On the other hand, you were talking about the benefits which the employee who retires is able to derive, and you said those benefits were 21 percent.

You cannot add 6½ and 6½ and get 13 and assume that that is all the money that is available to provide benefits.

There is interest on the income, and there is the benefit or the added increment that is created because some people do not claim their retirement, for one reason or another, death, or other things.

Does that help clear up this area of slight uncertainty?

Mr. KEOGH. I would say, Senator, it partially explains the difference, but only a slight part of the difference.

The only point I sought to make in a recitation of those relatively simple figures was that it seemed to me that those figures present a rather weak argument against this bill.

Senator BENNETT. I agree with you.

Mr. KEOGH. Because the argument was advanced on the basis that we should give the Federal employees deductibility for their share. And I touched upon the railroad retirement system, which, if we gave tax deductions for the employees' share of that system, it would be the most unique retirement system that I have ever heard of, and I daresay that has ever existed, for it would be completely tax exempt on the paying in and on the receiving out for a class of people numbering less than a million.

I suggest, Mr. Chairman, that that tends in the direction of special interest legislation far more than the pending bill does. And when this bill is described by anyone as special interest legislation, I say to him—and if not to him, I say to any other one who can objectively and somewhat dispassionately equate the merits of the legislative system—that a bill designed to be of benefit to 9 million self-employed and professional people in this country and 10 million of their employees is not a bill, which, in my opinion, falls into the classical and the generally accepted interpretation of "special interest" legislation.

And therefore, Mr. Chairman, I urge that your great committee give to this proposal the fine, careful consideration that I know it will give, and that you will report to the body which you here represent a piece of legislation of which we all may be proud.

The CHAIRMAN. Thank you very much, Mr. Keogh.

Senator Kerr desires to ask a question.

Senator KERR. Congressman, I want you to know that my being late in arriving does not indicate a lack of interest either in your bill or your testimony.

Mr. KEOGH. If I may interrupt you at that point, Senator, one of the nice things with my relationship with this committee and your body is that neither one has ever had to explain to the other.

Senator KERR. I never move from the necessity imposed by another, I often move from a desire to be understanding and considerate of another.

Is that clear?

Mr. KEOGH. Yes, sir.

Senator KERR. I did not ask for additional time for the witness, I understood he had used his own right in that regard; I only asked for a moment for myself.

I want you to know that I hope to read your testimony, both in order that I might be informed, and to be delighted, because I know it is that kind of testimony.

Mr. KEOGH. Thank you very much.

Senator KERR. The question I would like to ask you is this: Have you addressed yourself in your testimony to your feeling about the language of the bill which this committee reported out last year?

Mr. KEOGH. Yes, sir; I did, but briefly.

Senator KERR. Did you address yourself to that in your testimony? I expect to fully read your testimony, and if it is already there, you do not need to burden the record with a repetition.

Mr. KEOGH. I did, but briefly, Senator, and it will take me just a moment to mention to you that it is my firm conviction that any provisions affecting or intruding upon the existing law should be provisions that come in by themselves, stand on their own, or fall, and not complicate this bill by their inclusion therein.

Senator KERR. Now, would you place into the record the identification of those things with reference to this bill?

That is the only thing my question was intended to go to, not with reference to amendments on other matters; I address myself only to the revision of H.R. 10, which was fashioned by this committee.

Mr. KEOGH. We took H.R. 10 as it was reported by the Senate Finance Committee in the last Congress. We eliminated from it any of the provisions affecting the existing qualified pension plans, whether they be owner-managed or otherwise, and have confined our provisions only to the self-employed.

Senator KERR. But your provisions with reference to the self-employed are not identical to those which were contained in the Senate committee bill as reported, or in the bill as reported by the Senate Committee?

Mr. KEOGH. No; that is true.

Senator KERR. And that is the thing to which I would like to have your comment. And I would be happy for you to put it into the record. It might be easier for both you and me.

Mr. KEOGH. My reaction to that statement, Senator, is what I mentioned earlier——

Senator KERR. I had not intended it to be a question.

Mr. KEOGH. The difference between the bill reported by your committee and the pending bill insofar as the self-employed are concerned are neither great nor irreconcilable.

We have, for example, used the self-employment income as the base. You used the earned income.

We have provided that the plan would not require the inclusion of employees unless there were more than four employees with 3 years of service.

Senator KERR. I heard your remarks with reference to that difference.

Mr. KEOGH. Permit me to suggest that you, or to say to you that with respect to the form of the bill which your committee reported last year affecting the self-employed, my position would be one of easy acceptance.

Senator KERR. And approaching it from the standpoint that if there were some differences they could be reconciled in conference?

Mr. KEOGH. In my opinion, without any trouble at all.

Senator KERR. Thank you very much, Congressman.

I want you to again know that I regard you as not only one of the ablest men I know, but probably the best-informed man I know on

this matter, and I have tried to move as one of your converts in espousing and favoring the principle of your legislation.

Mr. KEOGH. You are most kind in your charitable remarks, Senator.

I am delighted to hear of your conversion in this field. And I am sure that I do not surprise you when I say that the work of conversion needs to be continued.

Senator KERR. It is not over?

Mr. KEOGH. Not completely.

Senator KERR. I want to say this about my adherence to the bill.

That was a matter of a long time ago, it was not a matter of recent occurrence. And I know, as well informed as you have been, that you were aware of it.

At the conclusion of the Congressman's remarks, I would like to place in the record the statement of Tom Steed of Oklahoma, who was, I believe, a joint sponsor of your legislation in the House.

Mr. KEOGH. Indeed he has been.

The CHAIRMAN. Without objection, the insertion may be made.

(The statement referred to follows:)

STATEMENT OF CONGRESSMAN TOM STEED (DEMOCRAT, OKLAHOMA) TO THE SENATE FINANCE COMMITTEE IN BEHALF OF H.R. 10, JULY 25, 1961

Mr. Chairman, as a joint sponsor of H.R. 10 in the last three Congresses I want to express my appreciation to you and your committee for your consideration of this issue.

Others are presenting to you the detailed provisions of this measure, which is designed to encourage the establishment of voluntary pension plans by self-employed individuals.

The measure follows the general form of the bill reported by your committee in the 86th Congress. However, it contains several significant changes, including the elimination of all proposed restrictions on corporate pension plans covering owner-employees, the revision of the requirement that the self-employed include their own employees under the plan so that it applies only if such fulltime employees are more than three in number, the modification of the limitations of last year's bill on the amount of contributions that can be made on behalf of owner-employees, and the substitution of self-employment earnings as the basis for the self-employed individual's contribution rather than earned income.

Some 7,500,000 persons would be affected by this measure, including an estimated 13,000 in my own Fourth Congressional District of Oklahoma alone. The huge majority of this number is made up of small independent businessmen. These people are typical of those whose initiative and enterprise help to build up the strength of our economy. In my work on the House Select Committee on Small Business I have had ample occasion to see their need for more equitable tax treatment. I am glad to urge the adoption of this measure, giving them a right already possessed by those under corporate and union plans, as an act of simple justice.

Mr. KEOGH. If I may be permitted to answer that, being conscious of the danger of singling out any individual or group, I am happy to say to the distinguished Senator from Oklahoma that Representative Steed has done and is continuing to do a great work in aiding in the advancement of this legislation, along with other Members of the House.

The CHAIRMAN. Senator Gore.

Senator GORE. The process of conversion, I take it my friend would concede, is a two-way street.

Senator KERR. There are many sinners who would desire it to be so.

Senator GORE. My friend from Oklahoma has leaped into the spiritual field. I was being more pragmatic, speaking of material things.

Senator KERR. Is that a pragmatic process?

Senator GORE. I believe so.

Congressman, you referred to a number of statements of Secretary Surrey. You did not refer to his statement that H.R. 10 would establish a precedent of permitting retirement annuities to be built up through a tax deduction based on a return on capital.

Mr. KEOGH. I thought I addressed myself to that, Senator.

I indicated that in a prior form of the bill we predicated—we computed—the deductions on earned income, and the Treasury Department opposed that and said it would be easier for them in the administration of the act to have the self-employed income reported as is reported for social security purposes.

Senator GORE. And now you favor allowing retirement annuities to be built up through tax deductions based on unearned income?

Mr. KEOGH. No. I did not advance that, to my knowledge, at any time.

Senator GORE. Well, Secretary Surrey says H.R. 10 provides for that.

Mr. KEOGH. That is true. But that does not say that I have advanced that theory. And I said we should not be bound by any opinion expressed by Secretary Surrey. But if you——

Senator GORE. I would like to understand you.

Do you deny the existence of that provision in your bill?

Mr. KEOGH. No, I do not.

Senator GORE. Do you favor that provision?

Mr. KEOGH. Well, I am relatively indifferent as to what the base is; all I want to do is to permit these people to make some contributions.

Now, I would say to you, Senator, right here and now, that if this process of pragmatic conversion could be furthered, I would say to you immediately that I would accept now an amendment to change that base to the earned income if that is the only obstacle that lies between you and supporting it.

Senator GORE. Maybe I am succeeding.

Mr. KEOGH. We had the earned income in.

Senator GORE. But it is not in now.

Mr. KEOGH. I understand that. But that does not mean to say that I am going to insist that that be the base. I have tried to make it as clear as I could.

Senator GORE. But it is in the bill which you support?

Mr. KEOGH. For the reasons that I have mentioned, yes, of course, Senator.

Frequently provisions are in bills that we support that we would prefer not to have in them.

Senator GORE. Do you thus classify this provision?

Mr. KEOGH. No.

The base upon which the computations are computed in my opinion is relatively unimportant.

Senator GORE. I cannot accept that. I can accept that as your opinion, but I cannot accept it as being valid.

Mr. KEOGH. I am only expressing it as my opinion.

Senator GORE. I understand. And you do not mind if I find some disagreement?

Mr. KEOGH. No, sir.

Senator GORE. If one is a partner in 10 partnerships, each different in identity, each of which is a profitable venture, but from neither of which one draws a salary—

Mr. KEOGH. A partnership?

Senator GORE. A partnership—10 separate partnerships, each of which returns a profit of $2,500 to partner A—would it not be possible for partner A to deduct $2,500 as a contribution, a deductible contribution, to his personal benefit from each of the 10?

Mr. KEOGH. Absolutely not.

The limitation is 10 percent of his income, whether self-employed or earned can be later decided, or $2,500, whichever is the lesser. And he could be a member of a thousand partnerships, and could make $10,000 from each one of them, and under this bill he would be limited to a maximum contribution of $2,500.

Senator GORE. Secretary Surrey said there was no limit.

Mr. KEOGH. Well, I am not going to assume to defend or explain the Secretary's statement. Where does he make that statement?

I read that transcript. The Secretary was rather interesting in some of his answeres, I would say, including the words "I think," or "it would appear," or "it would seem."

Senator GORE. You asked me where he made it.

If you really wish me to read it, I will have to take a few minutes to find it.

Mr. KEOGH. Never mind about that. Let's get back to your question.

And if you have a copy of the bill before you, I refer you to page 25, beginning on line 3, where there is a specific provision for contributions made under more than one plan, and there is an overall limitation which specifically—and I think in my opinion rather clearly—indicates that the overall limitation of $2,500 would apply.

Mr. ORAM. I agree that that would be quite true if there were no more than three employees, but if there were more than three employees, then the ratio of the self-employed contributions would not be the same as the three employees, but could not be more than $2,500 for the employees if the employees got the relatively same percentage.

For example, if the employees each got 10 percent, in each case if there were more than three employees, the self-employed person could get 10 percent of his aggregate income.

Is that not correct? I think that is correct.

Mr. KEOGH. I would take the position that it was not the intention of the legislation to permit that to happen.

Mr. ORAM. In the case that Senator Gore cited, there were 10 partnerships, from each of which the individual drew $2,500. So in this case 10 percent of $25,000 would still be $2,500 as a maximum limit.

But if he gave his employees 20 percent, then he could have 5 percent for himself if there were more than three employees. I believe that is correct.

Senator GORE. Without continuing the technical discussion, in any event I take it that you do not advocate deductible contributions to one's personal retirement fund based on unearned income, and that you favor limiting all deductions which any one person can receive to $2,500 per year.

Mr. KEOGH. That is a very important question, Mr. Chairman. May I ask the reporter to repeat it to me, please?

(The question referred to was read by the reporter.)

Mr. KEOGH. Yes, I would take that position, except I would say to you that, using self-employment income as the base, does not necessarily mean that the individual will be including unearned income, for the term "self-employed income," as I understand it, affords him the opportunity to include the return on his business, which would be personal services plus any capital equipment used.

I do not think that the use by the dentist of his office equipment which generates income for him is unearned income. That is the only clarification I would make there.

Senator GORE. But in essence, you would eliminate deductibility for return on capital?

Mr. KEOGH. I would be willing to negotiate with you on that, Senator.

Senator GORE. That is not subject to negotiation as far as I am concerned. This would enact a precedent in our tax law which I think would be most unfortunate, and the end of which one could not foretell.

Now, if you favor this principle with respect to the self-employed, do you think there should be some limit on the deductibility of corporate contributions with respect to an individual retirement?

Mr. KEOGH. I do not think the question arises squarely. I do not think it is created by the pending bill.

Senator GORE. I understand that.

Mr. KEOGH. And I have not come prepared—no, I withdraw that statement—I would prefer not to be drawn into a discussion of whether section 401 should or should not be amended by restrictive legislation.

Senator GORE. I will not seek to draw my colleague into a discussion of anything contrary to his will. But I would like to suggest that you cited the existence of corporate pension plans as a justification for H.R. 10.

I was pleased to see you suggest your willingness to limit the deductibility under H.R. 10. And I was only seeking to obtain your willingness to agree to similar limitations with respect to corporate pension plans, but I will not persist.

Now, I would like, however, to ask you one additional thing. If you do not wish to go into it, it will be all right.

Do you think a retirement insurance policy should have preference over an insurance policy for the education of one's children?

In other words, do you think a taxpayer without a child, who can invest $2,500 per year for a retirement insurance policy for his own personal benefit, should have a tax deduction of $2,500 per year for that purpose, while another taxpayer with the same earnings, the same income, with a child to educate, spends $2,500 per year for the education of his child?

Now, do you think the taxpayer without a child should have a tax deduction and the taxpayer with the obligation of educating his child should not have a tax deduction?

Mr. KEOGH. I think that every citizen in this country who is gainfully employed should have the right himself, if it is not done by

others, to provide for his superannuation. And I think that it is not important nor is it pertinent as to whether that individual has, by reason of his conforming to social mores, acquired any other obligations, whether those obligations be to a child or to a parent or to a dependent relative.

Senator GORE. No, but that misses the point.

Mr. KEOGH. Maybe it does.

Senator GORE. Maybe you intended it to.

Mr. KEOGH. No. I did not intend it to. I meant to give you squarely an answer to your question, and I think, if you will pardon my saying so, I think it is simply attempting to confuse the basic issue to bring in a question of the education of one's child.

We are here to provide for one's superannuation.

Senator GORE. Whether one attempts to clarify or confuse may be a matter of opinion. I was undertaking to examine the justification of a given tax deduction. The law permits a personal deduction of $600 to the taxpayer for each dependent; is that right?

Mr. KEOGH. I understand so.

Senator GORE. A deduction for one's personal benefit, for one's retirement, would be a personal deduction, would it not?

Mr. KEOGH. Well, Senator, you have constantly referred to this proposal as a tax deduction. I have not sought to clarify that point up to now.

We here do not propose a tax deduction; we propose merely a tax deferment, which has a vast, vast difference.

Senator GORE. Well, tax liability, like justice, long deferred, is denied.

Mr. KEOGH. And we are here for the 11th consecutive year seeking that justice which has been denied by being delayed.

Senator GORE. And not for the eleventh year, but as I have done many times before, I am seeking in tax law to bring justice to all taxpayers, not to a selected few, or a privileged group. So you and I are engaged here in an examination of this question in pursuit of our aims. And I am asking you if taxpayer A and taxpayer B have identical incomes, taxpayer A has children to educate, and taxpayer B has no children, no dependents, and taxpayer A spends $200 per month in buying educational insurance policies for his children, after which he is unable to invest in a retirement insurance policy for himself, and taxpayer B, being without dependents, from his income is able to and does invest $200 in a retirement policy for himself, would you give a tax deduction to B and deny it to A?

Mr. KEOGH. No, I would not give a tax deduction to B and deny it to A.

Senator GORE. Would you give tax deferral to B and deny it to A?

Mr. KEOGH. If it is to accomplish the objectives of this bill, I would say to you, Senator, that in my opinion it is not a compelling or convincing argument for you to describe two indviduals who are obviously not similarly situated.

Senator GORE. But one has children and the other does not.

Senator SMATHERS. On that point, is it not a fact that the person that has children is doubly blessed?

I have two lovely children, and I think I am.

Senator GORE. But I am trying to have them doubly blessed by the tax law.

Senator BENNETT. But the man with children has an exemption.

Senator GORE. The man with children gets an exemption of $600 for each child. And if I know of an inequity in the law, that is it. But here we have before us a bill that would give to one individual a tax exemption of $3,100, while leaving the fellow blessed with children a tax exemption of $600 for himself and each child.

Senator SMATHERS. If the Senator would yield, does he know any childless parents that would probably not give up a little money if they could have children?

Senator GORE. We are not talking about parental desires, we are talking about a tax law. And here we have an utterly inequitable proposal that would treat one taxpayer discriminatorily, giving a tax exemption or tax deferral to the childless taxpayer for the purpose of purchasing a retirement insurance policy for himself, while denying it to a man who spends a similar amount for the education of his children.

Senator MORTON. You do not deny it.

Senator GORE. If you intend to proceed upon this course of having one wrong justify another, then I say to you that the whole tax structure of this country is headed for contempt on the part of the taxpayers, and that would be a dangerous condition.

We should strive to pass laws in the public interest, not in the interest of special groups.

Now, I acknowledge that there are——

Mr. KEOGH. I addressed myself to that opinion earlier.

Senator GORE. Yes. Before the Senator from Florida came in, I cited the news report this morning about Mr. Colbert's resignation, after having done such a remarkable job as president of Chrysler Motors. That word "remarkable" can be interpreted as the stockholders choose. And he resigns now with retirement benefits estimated $92,000 per year, yet neither this committee nor the distinquished committee of which the Congressman is a member undertakes to do anything to limit the abuses of corporate pension plans.

It seems to me instead of having one wrong justify another until we build mountain peaks of special privilege, we should undertake to do justice to the average taxpayer.

Senator SMATHERS. Has the Senator from Tennessee presented a bill to rearrange these corporate pension plans and eliminate these inequities?

I do not know whether that is necessarily related to this particular program.

Senator GORE. I think it is related. And during the consideration of H.R. 10 last year I offered several amendments to that end. And I assure you there will be several more when we go into executive session on H.R. 10 this year.

Senator SMATHERS. I have no doubt about that. We have had that problem come up before, and undoubtedly will have it up again. It is just, of course, a matter of opinion as to where the inequity really lies.

I know what the Senator really thinks. I happen to agree with the Congressman from New York in this matter, that there is an inequity, there may be others, but certainly there is an inequity where 9 million self-employed people are not permitted now to have the same tax benefits as all the other people.

Senator GORE. I recognize that there are inequities.

I propose that we proceed to remove the inequities rather than create more.

Senator BENNETT. Mr. Chairman, I have been quite interested in this passage. It would seem to me that if you follow the reasoning of the Senator from Tennessee to its ultimate conclusion, you should eliminate all deferments, all exemptions, and tax income exactly the same for everybody, get rid of the dependency exemption, get rid of all special conditions, and put in a gross income tax, because then you can say that everybody is being treated exactly the same on the income he receives.

That is where I think this argument would ultimately lead.

Mr. KEOGH. I am now in the relatively fortunate position of not having to react to either one.

Senator BENNETT. I have one question that really has to do with this problem that the Congressman has been discussing.

I am interested in listening to the discussion about earned income and investment income.

What will you do with the farmer—will you say that the income he receives from the product of his labor is all earned income; will you ignore the fact that he has an investment in land and buildings?

Is this not a very difficult problem, because you cannot separate in some cases earned income from investment income?

Mr. KEOGH. It is.

As a matter of fact, we impute income to the farmer in certain instances and up to certain minimum levels with the consciousness that part of his income is the result of his capital equipment.

My point with respect to that is that I do not want to be drawn into a discussion of the kind of tree it is when what we are trying to do is clear the forest.

Mr. Chairman, in my desire to conserve the time of the committee I omitted to make brief reference to several areas in the bill where your committee might, in my opinion, give consideration to clarifying or amendatory language.

The first is with respect to fixed-premium annuity contracts. There may be some opinion expressed to you that the penalty provisions in the bill might work onerously in that area.

My attitude to that is that I think that all the alternative forms of investment contained in the bill should be maintained, as far as possible, in pari passu. I am not too impressed with the argument that the penalty provision might place burdens on those seeking to sell fixed premium annuity contracts.

As I understand their argument, it is that that fixed premium may one year be greater than the limits allowed by the law, and the penalties might attach. I think that can be worked out. The fact of the matter is that the imposition of the penalties should tend to discourage overselling by overzealous and overcapable insurance salesmen in this rather attractive form of investment.

You might also want to give some consideration as to whether you would qualify the certificates in the real estate investment trust field, an enactment which we recently put into law.

There may be some testimony later with respect to necessary clarifying language rendering eligible the face amount certificates which are provided in the bill.

There have been questions raised which I think we should look at carefully as to what effect the language in the pending bill has on the rights of designating beneficiaries in existing 401 plans.

I have touched upon the Long amendment, and now I am concluding. And I renew again, Mr. Chairman, my deep appreciation for your graciousness and your kindness in scheduling this hearing, and for what I trust will be early and favorable action by the committee on this legislation.

The CHAIRMAN. We have been glad to have you, Mr. Keogh.

Senator GORE. May I say, I thank you for coming. Your testimony has been very heful. And my exchanges with you have been pleasant.

The example that I intended to cite was of 10 different partnerships from each of which partner A receives $25,000 in income rather than $2,500. I think that would make a more appropriate example.

Again I thank you.

Mr. KEOGH. Mr. Chairman, if I may be permitted, I would like to close on this note, and that is, I find myself in disagreement with the Senator from Tennessee so seldom that I am not going to permit this solitary instance this morning to disturb what has been over the years a very pleasant and for me a very encouraging and profitable relationship.

Senator GORE. It shows he is still a missionary bent upon conversion.

Senator MORTON. I am glad to see this great demonstration of unity in the majority party.

The CHAIRMAN. The next witness is Dr. Roger F. Murray of the American Thrift Association.

Dr. Murray, will you take a seat, please.

Dr. Murray, Senator Kerr has requested me to say that he has been called from the room and was sorry not to be able to be here to express his friendship and admiration for you.

STATEMENT OF ROGER F. MURRAY, AMERICAN THRIFT ASSEMBLY, ACCOMPANIED BY LESLIE RAPP

Mr. MURRAY. My name is Roger F. Murray. I am the S. Sloan Colt Professor of Banking and Finance in the Graduate School of Business of Columbia University.

Senator GORE. Do you actually teach?

Mr. MURRAY. Yes, sir.

I am also director of the pension research project of the National Bureau of Economic Research.

I am accompanied this morning by a distinguished tax expert known to many of you for his long service to the Ways and Means Committee of the House of Representatives, Mr. Leslie Rapp.

It is my privilege to appear today on behalf of the American Thrift Assembly. Some 69 associations of self-employed individuals in almost every sphere of activity throughout the Nation have recorded their support of H.R. 10 through the American Thrift Assembly.

With your permission, Mr. Chairman, I should like to present a list of these organizations for the record.

The CHAIRMAN. Without objection, the insertion will be made.

(The list referred to follows:)

NATIONAL ASSOCIATIONS WHO HAVE ENDORSED H.R. 10 THROUGH THE AMERICAN THRIFT ASSEMBLY

American Angus Association.
American Association of Consulting Chemists & Chemical Engineers.
American Association of Medical Clinics.
American Association of Small Business.
American Bar Association.
American Brahman Breeders Association.
American College of Radiology.
American Dental Association.
American Guernsey Cattle Club.
American Hereford Association.
American Hotel Association.
American Institute of Architects.
American Institute of Chemists.
American Jersey Cattle Club.
American Medical Association.
American National Cattlemen's Association.
American Ophthalmological Society.
American Optometric Association.
American Patent Law Association.
American Podiatry Association.
American Quarter Horse Association.
American Society of Industrial Designers.
American Society of Internal Medicine.
American Society of Landscape Architects, Inc.
American Retail Federation.
American Shorthorn Breeders' Association.
American Thoroughbred Breeders' Association, Inc.
American Veterinary Medical Association.
Association of Consulting Management Engineers, Inc.
Association of Stock Exchange Firms.
Authors League of America.
Automotive Affiliated Representatives.
Commercial Law League of America.
Contracting Plasterers' and Lathers' International Association.
Holstein-Friesian Association of America.
League of New York Theatres, Inc.
National Association of Dance Teachers Organizations.
National Association of Homebuilders of the United States.
National Association of Plumbing Contractors.
National Association of Retail Druggists.
National Assiciation of Retail Grocers.
National Association of Retail Meat & Food Dealers, Inc.
National Association of Tax Accountants.
National Association of Women and Children's Apparel Salesmen, Inc.
National Association of Women Lawyers.
National Automobile Dealers Association.
National Council of Salesmen's Organizations, Inc.
National Farmers Union.
National Federation of Independent Business.
National Food Brokers Association.
National Funeral Directors Association.
National Lamb Feeders.
National Liquor Stores Association, Inc.
National Live Stock Tax Committee.
National Milk Producers Federation.
National Shorthand Reporters Association.
National Restaurant Association, Inc.
National Roofing Contractors Association.
National Small Business Men's Association.
National Society of Professional Engineers.
National Society of Public Accountants.
National Sugar Brokers Association.
National Wholesale Furniture Salesmen's Association.
National Wool Growers' Association.

NATIONAL ASSOCIATIONS WHO HAVE ENDORSED H.R. 10 THROUGH THE AMERICAN THRIFTY ASSEMBLY—Continued

Bureau of Salesmen's National Association.
Painting & Decorating Contractors of America.
Society of American Florists.
Society of Magazine Writers.
The National Grange.

Mr. MURRAY. Obviously not all of these associations are equally enthusiastic about every provision of the bill. Yet their conviction as to basic need for remedial legislation has lead them to join in endorsing H.R. 10.

To cooperate with the committee, they have restrained their natural desire to ask to be heard in person, and many of them have agreed to file statements for the record instead.

As this committee approaches action on the revised version of H.R. 10 as passed by the House, I urge that careful consideration be given to three basic points which especially commend this bill to your favorable action.

The first of these points is the matter of equity. You can take justifiable pride in the fact that social security coverage has been spread to the overwhelming proportion of people regularly in the labor force. You can also take pride in the fact that over 30 million employees of public and private organizations are now covered under pension programs which supplement OASI.

And this number continues to grow at the rate of more than a million employees a year.

Senator SMATHERS. Did you say 30 million?

Mr. MURRAY. Yes, public and private employees.

Senator GORE. Self-employed are covered under this program, too, aren't they?

Mr. MURRAY. I am speaking now of those covered under supplementary plans.

Senator GORE. You spoke of social security just a moment ago.

Mr. MURRAY. Yes, sir.

Senator GORE. I don't pay any self-employment social security tax.

Mr. MURRAY. I was speaking of the 30 million who are covered by supplemental plans in addition to social security.

Senator GORE. But the self-employed are covered under the social security program.

Mr. MURRAY. Yes, they are.

Senator SMATHERS. But they are not within the 30 million?

Mr. MURRAY. They are not within the 30 million.

We have found in our research studies that coverage under these supplemental plans seems to encourage people to contine or even increase their savings in other forms. Those who are pessimistic about the American people have been wrong again. OASI and public and private pension plans have nurtured, not destroyed, the determination of employed people to work and save toward economic security and financial independence for their years after retirement.

Over the years this committe has played a key role in providing the structure and the incentives which have made it possible for these 30 million citizens to work toward attaining dignified independence

instead of relying upon their families, or on public and private charity.

The Revenue Act of 1942 changed pension plans from class legislation to mass legislation by requiring that qualified plans cover the work force as a whole.

The results are found in this record of growth to a coverage of 30 million people.

But we are not contented with even this spectacular rate of progress. Less than 2 weeks ago, it was my privilege to appear at hearings conducted by Senator Smathers for the Senate Special Committee on Aging to study the subject of retirement income.

The persistent question raised again and again is this. What public policies can we adopt which will expedite the process of spreading pension coverage to a larger proportion of our working citizens?

I do not think we have far to look for an answer.

We can extend the same incentives for the establishment of a retirement program to an estimated 9 to 10 million self-employed, and their more than 10 million employees, by the enactment of H.R. 10.

This would simply involve extending the incentive of tax deferral on the employer's contribution, which has been repeatedly indorsed by this committee, to the largest single group of uncovered people. It would be applying a time-tested and effective policy to everyone. It would be removing a discrimination against self-employment.

The Treasury has repeatedly affirmed that, and I quote,

present law does not give self-employed persons tax treatment for their retirement savings comparable to that now accorded to employees covered by employer-financed pension plans.

Should the provisions of the tax law be permitted longer to operate in the direction of exerting economic pressure on an individual to seek employment with a corporation or with the Government instead of working for himself?

At present, seeking employment is the only way in which tax deferral can be obtained on the employer's contribution to a pension program.

The law in its present form encourages orderly provision for old age, unless a man or a woman has the ambition and enterprise to be his own boss. This was not an intentional inequity to the self-employed, it was the simple result of the difficulty in framing legislation to cover those who stood, not in a clear employee relationship, but rather in this dual role of employer and employee as self-employed individuals.

To conclude my first point, therefore, this is a matter of equity.

To state my second point, a way has now been found after a decade and more of work by many Members of the Congress from both parties to deal with the problem of the dual role of the self-employed.

In other words, a practical, feasible way has been found in H.R. 10 to deal with the self-employed and with the employees of the self-employed. The changes and revisions in H.R. 10, in the present bill, also, it seems to me, accomplish the main objectives of the bill developed by this committee in the 86th Congress.

In essence, the present proposal treats the self-employed for retirement plan purposes as the employers of themselves, which indeed is precisely what they are. Because the self-employed are also owners

of their business, or at least part owners, it has been thought necessary to include certain limitations and restraints not applicable to the typical corporate pension plans which qualifies under Treasury regulations.

Some people have argued that these limitations are excessively harsh, but I personally feel that H.R. 10 goes such a long way to remove the inequity against the self-employed in their efforts to provide for themselves that we should not quarrel with safeguards designed to prevent isolated instances of abuse of the tax deferment privilege.

Senator GORE. What was that statement, we should not what?

Mr. MURRAY. We should not quarrel with safeguards designed to prevent isolated instances of abuse of the tax deferment privilege.

Senator GORE. I don't quite understand what you mean. Do you mean we should not have safeguards, or we should——

Mr. MURRAY. We should not object to safeguards, we should not quarrel with extra protection.

Senator GORE. In other words, you are for safeguards?

Mr. MURRAY. Yes, sir. I was saying that some people object that there are too many restraints and restrictions in H.R. 10. But I say, I am not going to argue with these, any more than Congressman Keogh is, if the prinicple has been established and is operative.

Senator GORE. Are you for H.R. 10?

Mr. MURRAY. Yes, sir.

Senator GORE. Then you realize that it is, according to Secretary Surrey, without limits?

Mr. MURRAY. I do not believe that Mr. Surrey can support the unqualified statement that H.R. 10 is without limits.

Senator GORE. Were you here?

Mr. MURRAY. I was here, sir.

Senator GORE. I thought I recognized you.

Can you disprove it?

Mr. MURRAY. Yes, sir. I can show repeatedly through the bill that there are specific limits.

Senator GORE. But you would favor that?

Mr. MURRAY. I am in favor of the limits in H.R. 10; yes, sir.

Senator GORE. Are you in favor of limiting a taxpayer to a tax deduction for one retirement policy?

Mr. MURRAY. I do not care whether it is one policy or many policies, so long as there are overall limitations as provided in H.R. 10.

Senator GORE. What is that overall limitation?

Mr. MURRAY. $2,500, or 10 percent of self-employment income, except——

Senator GORE. The counsel for this committee just cited us a provision of the law in which that is not the case.

Mr. MURRAY. Except in the case of the employer of more than three employees, who may under a Treasury approved plan obtain a larger deduction if it satisfies the Treasury as being nondiscriminatory.

Senator GORE. And the bill also provides that after this plan of the employer with four or more employees is established, he may then dismiss all the employees and the plan continues. Are you in favor of that?

Mr. MURRAY. I think that this is the only workable provision. I assume—and I think that you would probably assume—that a man who dismisses all of his employees has no business and very little self-employment income.

Senator GORE. I would not assume such, because the bill provides that the deduction can relate to return on capital. This so-called partnership might be established for the purpose of managing a building, or collecting royalties from an oil lease. The employees really might not be needed for more that 1 year, if at all, except for the purposes of establishing a pension plan.

Mr. MURRAY. Well, sir; the more than three employees provided for in the bill must be regular employees——

Senator GORE. The bill doesn't so require.

Mr. MURRAY. I believe it eliminates part-time and seasonal employees.

Senator GORE. That is different from regular, though.

Senator ANDERSON. Why don't you cite the provision where it contravenes with Senator Gore's bill?

Senator SMATHERS. I would say this, that we had a limitation in the bill that the Senate had in force last year, and you have got a limitation in the bill which I have introduced—as I understand the testimony from Congressman Keogh, he was willing to submit to most any kind of a limitation so long as the idea of allowing the self-employed to set up a retirement program was agreed to.

Mr. MURRAY. I believe on page 4 of the bill is the section which covers more than three employees—

for the purposes of the preceding sentence the term "employee" does not include any employee whose customary employment is for not more than 20 hours in any 1 week, or is for not more than 5 months in any calendar year.

Senator GORE. Let me read to you apart of Secretary Surrey's testimony, Mr. Chairman, if I may.

Self-employed individuals, having once qualified for the larger allowances as employers of four or more individuals, can continue to contribute amounts in excess of the 10 percent, $2,500 limit, in subsequent years, even if they have no employees in such years. Also because the bill specifically permits a self-employed individual to exclude from the plan employees who have less than three years of service, and at the same time to count them in determining whether he has at least four employees, it will be possible for the self-employed to contribute for himself more than the basic 10 percent, $2,500 amounts, without making any contributions on behalf of any other individual.

Then he proceeds to point out that the bill is without limit.

And yet you indorse H.R. 10 as it is.

Mr. MURRAY. Sir, I would feel that the intent of this particular draft is to make provision for fluctuating numbers of employees. A man could be employing four employees, and one of them could quit. And there may be some delay before he is able to replace him.

Senator ANDERSON. Do you believe in passing legislation on the basis of what the people intended, or what the bill actually says?

Mr. MURRAY. Sir, I think that if there is a rewording or restating necessary to carry out the intention of this law, I am sure that you gentlemen and your staff are much more competent than I to draft that correction.

I believe I am supporting, sir, without qualification, the purpose and intent of H.R. 10, I am scarcely qualified to submit a perfecting revision of the language.

Senator GORE. Doctor, as to intent, I would seriously doubt that Congress ever intended that the stockholders of a corporation and the taxpayers of the United States would provide retirement benefits of $92,000 a year for Mr. Colbert.

But that is what we have reported to us today.

So, as Senator Anderson has said, we must legislate provisions of law, not assume good intent on the part of all taxpayers.

Senator SMATHERS. Could I ask a question right there, Doctor?

Would there be any possible way for a self-employed man to acquire rights of $92,000 under this proposed H.R. 10?

Mr. MURRAY. It is absolutely inconceivable. As you can see, sir, a man working for 45 years, perhaps, if he were able to set aside $2,500 a year, that is, if he had the earning capacity from age 20 onward, which would be a rare thing, still his retirement annuity would be only a modest fraction of that amount.

Senator SMATHERS. So, then, you can categorically say that under this type of legislation this inequity, or this situation which the Senator from Tennessee complains about, and which I myself think is something that should be looked into, that could not happen under this proposed legislation?

Mr. MURRAY. It absolutely could not happen, sir.

Senator SMATHERS. One other question:

With respect to how many corporations the self-employed person might be in, is it not a fact that before a self-employed person could get qualified under more than one retirement system—is it not a fact that each one of these plans has to be approved by, we will say, Mr. Surrey and the Treasury, and can you conceive of Mr. Surrey and the Treasury approving of such a plan?

Mr. MURRAY. I certainly cannot, sir. And, as you may recall, the bill provides that what we are talking about here is self-employment, which is defined as giving substantially all your time to the activity.

Senator SMATHERS. Now, one other question:

Is it not a fact that in the bill which we had last year before the Finance Committee and which the Finance Committee considered, with respect to the employees of the self-employed, that when a retirement system was set up and approved by the Treasury, an employee had vested rights in that system, so that if the employee left the employment of the self-employed, the employee still had his vested interest, is that not correct?

Mr. MURRAY. That is correct.

Senator SMATHERS. That is all.

Mr. MURRAY. I have emphasized the need for this bill to remove an unintended inequity of the operation of the personal income tax.

I have also expressed our support of this bill as a workable, effective method of making the standard treatment of pension plans applicable to the special case of the self-employed.

A third important point is the persistent question of the amount of the tax deferment. The Treasury has provided an estimate of what they insist on calling the revenue loss in the amount of $325 to $358 million in a typical full year of operation.

I believe that I can prove to your complete satisfaction that such an estimate bears no resemblance to the realities of the 1962, 1963, and 1964 fiscal year revenues.

Indeed, I observe with interest the fact that Mr. Surrey was careful in his testimony not to say what full fiscal year this estimate of revenue loss applied to.

I do not challenge for an instant the ability of the Treasury experts to estimate the maximum conceivable revenue loss of any tax reform measure. Indeed, when comparable measures were enacted in England and Canada, the fiscal experts were so careful to take into account all factors which might maximize the revenue loss that their estimates were five or six times the actual result.

However, what you are interested in is not the largest conceivable figure, but some real indication of what the budgetary impact might be over the next several years.

This is the figure which I am here to present and defend against challenge from any source.

Senator ANDERSON. Could I interrupt?

Is there comparable legislation to H.R. 10 in England?

Mr. MURRAY. Yes, there is. The original estimate in Canada was that the revenue loss was $140 million. It turned out to be $7 million. And in England there was about the same ratio of overestimation.

Senator ANDERSON. Is this a law upon which H.R. 10 is patterned, or parallels?

Mr. MURRAY. These are slightly different in a number of respects.

In Canada, as I recall, it also may include individuals who are already covered under pension plans, that is, it can be supplementary. And they are different because they are based upon a different structure of retirement benefits generally.

Senator ANDERSON. Then why do you call them comparable?

Mr. MURRAY. They are comparable in the provision of a tax deferral on these accumulations for retirement benefits.

Senator ANDERSON. Would you give us the citation for those?

Mr. MURRAY. We certainly can provide it, sir. I do not have it with me, I am sorry to say.

Senator ANDERSON. I didn't expect you to have it with you.

(Mr. Murray subsequently submitted the following material which originally appeared in an article, by Leslie M. Rapp, which was published in the Tax Law Review, vol. 14 (1958) :)

THE BRITISH "JENKINS-KEOGH" BILL

On April 17, 1956, the British Chancellor of the Exchequer, Harold Macmillan, in presenting the budget to the House of Commons, put into effect a counterpart of the Jenkins-Keogh bill based on recommendations made in 1954 by the so-called Millard Tucker committee and later approved with certain modifications in the report of the Royal Commission on the Taxation of Profits and Income.[1] The British plan was said by the Chancellor to give the self-employed and the pensionless-employed "a measure of fiscal justice." It applies to all persons except those engaged in a "pensionable office or employment" in connection with which there is a "sponsored superannuation scheme."[2]

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[1] The plan is embraced in the Finance Act, 1956, 4 and 5 Eliz. 2, ch. 54, pt. III. (The Tucker committee was appointed in 1950 by a prior Chancellor to study the need for relief for the self-employed in respect of private pensions. For a general discussion of the British plan, see Kent, "The British Finance Act, 1956," 85 Taxes 219, 222 (1957).)

[2] Persons having income from both pensionable and nonpensionable sources are, however, eligible for participation to the extent of their nonpensionable earnings. See note 48 infra.

Eligible persons are allowed a deduction for income tax purposes of up to the lesser of 10 percent of "relevant earnings"[3] and £750 (approximately $2,100) with respect to amounts voluntarily put aside for their retirement.[4] In the case of persons born in 1915 or earlier, the allowable deduction is increased one-tenth for each 2 years of age over 40 and not over 50, determined as of 1956. Contributions in any year in excess of the allowable deduction may be carried forward and treated as having been paid in the following year or years until exhausted. The funds may be accumulated either through the purchase from an approved insurer of noncommutable, nonassignable annuities, or by contributions to an approved trust scheme.[5] In any case, however distributions can be made only in the form of lifetime annuities,[6] with or without survivorship benefits, but cannot commence before age 60[7] and must commence not later than age 70.

Proponents of the Jenkins-Keogh bill were quick to publicize the British measure and call for the enactment of similar legislation in this country.

THE CANADIAN "JENKINS KEOGH" BILL

While Congress took no action on the Jenkins-Keogh bill during 1957, a significant development occurred during the year in that Canada followed Great Britain in adopting legislation allowing a tax deduction to individuals for amounts voluntarily set aside for retirement purposes.[8] The Canadian plan, called the registered retirement savings plan, was put forward by the Finance Minister on March 14, 1957 and was the culmination of 10 years of effort by professional groups to secure equality of tax treatment with respect to private pensions.

In Canada, all persons having earned income are entitled to the benefits of the act. The self-employed and the pensionless employed are permitted an income tax deduction up to the lesser of 10 percent of earned income and $2,500 for amounts paid as premiums under a registered retirement savings plan.[9] Those covered by qualified employee pension plans may deduct only the difference between their own contributions under such employer-sponsored plans and an amount equal to the lesser of 10 percent of their earned income and $1,500.[10]

There are three permissible forms of investment: (1) Life annuity policies purchased from licensed insurers;[11] (2) savings or investment contracts providing for the payment of a fixed or determinable amount at maturity;[12] or (3) corporate trusts.[13] In the event investment contracts or corporate trusts are used, the funds must ultimately be applied for the purpose of providing the individual at maturity with an annuity for life. The contributions must be "locked in," that is, there can be no borrowing, no assignment, and no cash

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[3] In general, earnings from an office or employment, other than a pensionable office or employment, or from a trade, vocation, or profession.

[4] In the case of a person with income from both pensionable and nonpensionable sources, the pound limit on his deduction is reduced by one-tenth of his pensionable emoluments for the taxable year.

[5] The trust scheme must be established for the benefit of individuals engaged in or connected with a particular occupation or one or other of a group of occupations. Income tax exemption is granted to the trust. If no such trust scheme is established by a representative body the individual can only avail himself of the annuity-funding method.

[6] Except in case of death, in which case there can be a lump-sum repayment of premiums with interest.

[7] The Commissioners of Inland Revenue are authorized to make an exception in case of disability. Also, if the individual's occupation is one in which persons customarily retire before age 60, the Commissioners may permit an annuity to commence not earlier than age 50.

[8] Income Tax Act, 1957, 5 and 6 Eliz. 2, ch. 29, sec. 79B. For a general discussion of the Canadian plan, see Eaton (Assistant Deputy Finance Minister), "Registered Retirement Savings Plans," V Can. Tax J. 179 (1957).

[9] There is no provision under the Canadian law for a carryover of unused deductions or of amounts contributed in excess of allowable deductions. Nor is a higher deduction allowed for persons over a specified age.

[10] Under Canadian law, employees participating in a qualified contributory pension plan may deduct their own contributions up to $1,500 per annum. Income Tax Act, Can. Rev. Stat, ch. 148, sec. 11(1)(g) (1952).

[11] Existing policies may be qualified for registration if amended to meet the statutory requirements. Life insurance may also be used as an investment medium to the extent of the savings element.

[12] Must be purchased from a corporation authorized under Canadian law to issue such contracts; includes investment certificates.

[13] The trustee must be a corporation resident in Canada. It has been said that "the management and investment of these funds will be governed by the providence and wisdom of the persons receiving them and, of course, the general laws under which they operate." Eaton, supra note 72, at 181.

surrender value. Withdrawals, however, may begin at any time and, in any event, must commence not later than age 71. Since such withdrawals must be in the form of equal annual installments for life, lump-sum payments are not permissible except in case of the death of a participant before retirement. The annuity policy may be in joint and survivior form with the insured's spouse as cobeneficiary and may have a guaranteed period of not more than 15 years.[14]

Distribution under a registered retirement savings plan are taxed at regular income tax rates as and when received. Death benefits are subject to a flat tax of 15 percent.

While, as has been indicated, the participant's funds are "frozen" until the predetermined maturity date, the Canadian law contemplates the possibility that some participants may find it necessary or desirable to withdraw their retirement savings before maturity. Thus, provision is made in the statute that in the event a participant arranges to have the qualifying provisions of his policy canceled so that it no longer is eligible for registration, any distributions after deregistration which constitute the payment of accumulated savings[15] will be taxed at regular income tax rates, subject to withholding at the source at the rate of 25 percent (which constitutes the minimum tax payable). If the contract were to be amended to provide for a lump-sum distribution, there would be an automatic penalty by reason of the fact that the amount would be taxed at the individual's highest bracket rates.

The Canadian plan clearly is something more than a measure to remove a discrimination against the self-employed and the pensionless employed in the matter of retirement pensions. As the Assistant Deputy Finance Minister has well said:[16]

"The new legislation opens up income spreading as a new positive policy of general application. It is available to everybody."

The New Zealand Plan

Although not as comprehensive or as significant as the English and Canadian plans, New Zealand adopted during 1957 certain changes in its income tax law designed to give limited tax relief to self-employed persons with regard to their savings for old age retirement. The Minister of Finance in his budget statement stated that it was proposed "to extend to business and professional persons employed on their own account the income tax exemption at present available to employees of firms with staff superannuation schemes approved by the Commissioner of Inland Revenue."[17]

The writer has been unable as yet to ascertain the precise details of the New Zealand program.[18] Under prior law it appears that a tax deduction of the lesser of 15 percent of "assessable income" and £175 (approximately $490) was allowed to taxpayers for premiums on life insurance policies and employee contributions to approved pension plans. The recently enacted legislation is said to allow the self-employed a total deduction of £250 (approximately $700) for life insurance premiums and contributions to approved superannuation schemes for the self-employed. If he has already used his existing deduction for life insurance premiums up to the limit of 15 percent of assessable income or £175, whichever is the lesser, a self-employed person will have a further allowance of £75 for his contributions to a retirement plan. On the other hand, if the percentage limitation brings his allowable insurance deduction below £175, say, to £120, he can deduct his retirement fund contributions in an amount equal to the difference between the latter figure and £250.

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[14] In the case of policies issued before Mar. 14, 1957, the maximum period may be 20 years.

[15] Where a particular plan provides only an annuity at maturity and a benefit at death before maturity not exceeding the return of premiums with interest and dividends, the entire premium qualifies as a savings premium. The savings portion of the premium under other plans is determined by deducting from the total premium (a) premiums charged for disability, accidental death, and other additional benefits; (b) premiums charged for additional mortality risk, and (c) a nonparticipating gross level term insurance premium payable to the policy anniversary nearest age 65 or to the prior maturity of the policy calculated on the basis of standard mortality as being sufficient to cover the excess of the death benefit provided by the contract over the savings fund being accumulated.

[16] Eaton, *supra*, note 72, at 180.

[17] Financial statement by Hon. J. T. Watts, Minister of Finance, July 25, 1957.

[18] Such information as is given concerning the New Zealand plan is based solely upon articles appearing in New Zealand Commerce, Dec. 16, 1957, p. 17, and in Commerce J. 88 (December–January 1957–58).

It is understood that the Commissioner of Inland Revenue will not require each occupational group to operate its own superannuation scheme but will approve standard schemes to be submitted by life insurance companies and the National Provident Fund. Benefits will be payable only in the form of annuities (with or without survivorship privileges) commencing not earlier than age 60.

Senator BENNETT. In what year were these laws passed, how long have they been operating?

Mr. MURRAY. The British law was enacted in 1956 and the Canadian law a year later.

In the first place, we know that some employees of the self-employed are already covered under qualified plans. Where possible, the incorporation of partnerships and sole proprietorships is taking place, and association plans are being developed for the purpose of providing group retirement benefits.

I understand that the Treasury has no up-to-date information on the extent of these developments. And this was confirmed in Mr. Surrey's testimony.

It is evident that their continuation will contribute to the so-called revenue loss whether or not H.R. 10 becomes law. The laws of many States prevent professional people from using the corporate form to limit personal responsibility, but the pressure of the present inequitable treatment of provisions for retirement is gradually eroding the resistance to incorporation even among professional people.

The question is simply this: Is the Congress going to oblige the self-employed to incorporate in order to take advantage of existing law?

Or will they be permitted to do so simply by being treated as their own employers and employees as provided in H.R. 10?

By passing H.R. 10 the Congress would not be creating any revenue loss that does not potentially exist under present law if all the farmers and professional people and proprietors of small business were to carry on their occupations in corporate form, a trend which has already begun, due to the existing discrimination against them.

The second element of overstatement in the Treasury's estimate arises from their assumptions as to utilization of the provisions over the near future.

The only objective evidence on the question that I have seen is the result of a study which I reported in the hearings before your committee 2 years ago.

This sample survey casts grave doubt on the Treasury's standard assumptions, which they seem to carry forward to each successive version of H.R. 10 without apparent adjustment or modification for changes in the bill.

There are several substantial reasons for expecting that the rate of utilization of the tax deferrals will be nothing like the Treasury's estimate in the near future.

First, considerable time will be required to prepare all of the regulations and administrative arrangements for making the bill really operative.

Second, financial institutions will require time to prepare the facilities to receive contributions.

Third, the explanation and promotion of such plans by financial institutions and by associations of the self-employed is a major and time-consuming undertaking.

Fourth, savings habits are slow to change. New programs spread only gradually, and other savings objectives like homeownership and education compete with retirement saving institutions. I notice that the Treasury never refers to the volume of contributions which are assumed in an estimated revenue loss of $325 million or more. Perhaps this is because they, too, are staggered by the thought that they are assuming contributions of a billion dollars or more annually in the next year or two.

Based on my own experience, on the studies that have been made of savings over the years, on the methods and operations of financial institutions under comparable circumstances, the assumption of this level of a billion dollars a year of contributions in the near future is absolutely unrealistic.

It was not until 1956, after many years, over 30 years of intensive selling and promotion, that the mutual fund salesmen were able to push net sales of mutual fund shares to a billion dollar annual rate.

It took 100 years to produce a peacetime growth rate of a billion dollars a year in mutual savings bank deposits.

Working in a persistent bull market, the New York Stock Exchange's monthly investment plan didn't even attract its first hundred million dollars of total investment until the fifth year of operation.

If contributions for retirement income under the provisions of H.R. 10 reached a billion dollars a year, to support the Treasury's estimates, 5 or 6 years after enactment, I would be surprised and delighted that it had been so effective.

It just takes a lot of time, effort, and promotion to develop any new savings program on a large scale, no matter what the incentives and the advantages to the participants.

Senator ANDERSON. Are you trying to say that the tax avoidance program is the same as a savings program?

Mr. MURRAY. Sir, this is a provision of tax deferment on savings which people make, they must make the savings before they receive any tax deferment.

Senator ANDERSON. Well, the tax, when they pay it, hopefully will be much less than the tax that they would pay in their high years, so it is a tax avoidance program.

Now, do you mean to say that the purchase of mutual thrift programs is comparable in any way in attractiveness to the tax avoidance program?

Mr. MURRAY. Sir, it might be considered comparable to the purchase of tax-exempt bonds by people in high-income groups.

Senator ANDERSON. If so, then a billion dollars a year wouldn't be very high; would it?

People buy those pretty freely; do they not?

Mr. MURRAY. When you study the estate tax returns of wealthy individuals, the amazing thing always is to me the relatively small proportion of the investments which they make in tax-exempt bonds.

Senator ANDERSON. Where do you get that?

Mr. MURRAY. Sir, I believe the study at the National Bureau of Economic Research completed recently, based on tax returns, and on the asset holdings of estates in excess of $60,000, supports this statement.

Senator ANDERSON. We are talking about very rich people.

You don't regard $60,000 in an estate as being very rich; do you?

Mr. MURRAY. All estates over $60,000, up to the very large figures are in the study.

Senator ANDERSON. Yes, but you are going to average into that everybody that makes sixty, seventy, eighty or ninety thousand dollars, and put those in with the higher people?

Mr. MURRAY. The breakdown is available by size category.

State and municipal bonds as a percentage of gross taxable estates, 1950 and 1955

[In percent]

	1950	1955
By size of net estate (in thousands of dollars):		
Under $100	0.5	0.2
$100 to $199	1.0	.4
$200 to $299	1.8	.9
$300 to $499	3.4	1.7
$500 to $999	5.4	3.6
$1,000 to $1,999	7.9	6.6
$2,000 to $4,999	9.6	10.5
$5,000 and over	18.5	8.1

Source: Roland I. Robinson: "Postwar Market for State and Local Government Securities," Princeton University Press for the National Bureau of Economic Research, 1960, p. 75.

Senator ANDERSON. How many municipal bonds are bought in a year that are tax exempt?

Mr. MURRAY. The current rate is running around $5 billion, as I recall, of net new issues.

Senator ANDERSON. So they are interested in these things to the tune of a billion dollars or more; aren't they?

Mr. MURRAY. Individuals, sir?

Senator ANDERSON. Yes.

Mr. MURRAY. Well, of course, there is always a certain amount of investment and reinvestment, but——

Senator ANDERSON. Did you notice how many people moved into the cattle business when they got a tax advantage?

Mr. MURRAY. I really am not qualified to talk about that.

Senator ANDERSON. You ought to go out and check the cow country and see how much money moved quickly into the cattle business, and how many ranches that had been in the families for generations suddenly transferred because you were able to take the female stock and charge it off as capital gain because it was part of the factory. These tax advantages attract people very rapidly. I am surprised that you should not have recognized that a billion dollars is a very small amount of money to put in an attractive tax device.

Mr. MURRAY. Sir, the way we sell U.S. Treasury savings bonds provides a tax deferment for people. And yet the Treasury has had a tough battle——

Senator ANDERSON. You ought to be real careful about that, because I know a woman who cashed in some bonds a short time ago and criticized her husband very severely, because when they got through paying income tax she didn't have anything left out of the savings of these long years.

Now, you give them a good tax advantage and then they can understand it very well. When we had the program that you could build

a building and lease it for 5 years, depreciate it over the primary term of the lease and take it out in 5 years, do you know how much money was attracted in that field?

Hundreds of millions of dollars in a few months when they heard about the tax advantage.

Do you think that people wouldn't take advantage of this tax advantage?

Mr. MURRAY. Sir, you have looked at the provisions of this bill. You know the complexities of it. You know the rulings and administrative provisions that have to be made. You know what happens to a person when you tell them that he cannot take his money out. This is for keeps, when he puts it into his retirement plan. You know what a discouraging factor this is.

Senator ANDERSON. He takes it out of the Treasury and puts it over into this retirement plan, bear that in mind.

Mr. MURRAY. Sir, he may not take it out, however, without a high penalty. He is tying up his funds——

Senator ANDERSON. I am not talking about that. This is money that he would pay a great deal for in taxes, so instead of paying that in taxes because he is at the very top of the bracket, he moves into a fund that belongs to him so that he can put it in at a much lower rate of taxation.

You don't think that is attractive?

Mr. MURRAY. Sir, it is attractive in fulfillment of a retirement saving motivation. My only point, sir, is that this is not the only factor that motivates people in their savings forms.

For some people the most important thing is to buy life insurance protection. They are more concerned about the hazards of living to age 65 rather than the hazards of living after age 65. So there is a mixture of motives, sir, which is why you cannot say, "Well, we provide this tax deferment incentive; therefore, everybody is going to automatically take advantage of it to the full."

Senator ANDERSON. Do you regard it as solely a tax deferment?

Mr. MURRAY. Sir, this is the——

Senator ANDERSON. I asked you what you thought; do you think it is solely a tax deferment?

Mr. MURRAY. The proposal in H.R. 10?

Senator ANDERSON. Yes.

Mr. MURRAY. Yes, sir; I believe this is what I conceive of as tax deferment.

Senator ANDERSON. No; I didn't say that. I asked you, Do you think this is solely for tax deferment.

Mr. MURRAY. The bill, you mean?

Senator ANDERSON. The proposal; yes, the bill. Or is it for tax avoidance?

Mr. MURRAY. Sir, I believe this is for equalizing the opportunities afforded employees, whether they be employees of government or private industry or any organization, for tax deferment. This is a proposal to afford the self-employed with the same tax deferment on the employer's contribution to a retirement plan.

Senator ANDERSON. You have switched halfway down the road, haven't you? You started to say it was to equalize the taxation be-

tween some other people and this group of individuals. If it is, it must be a tax reduction. Is it or is it not a tax reduction?

Mr. MURRAY. Presumably tax deferment means that if the tax is paid at a later date it will be paid at a lower rate.

Senator ANDERSON. Is that what deferment means? Have you looked at the dictionary recently?

Mr. MURRAY. Deferment means postponement.

Senator ANDERSON. That is right; it doesn't mean reduced, does it?

Mr. MURRAY. That is right. It operates as a reduction.

Senator ANDERSON. It took a long time to get it, but it is a reduction.

Mr. MURRAY. Which is consistent with the treatment——

Senator ANDERSON. Senator Douglas suggests that there is a loss of interest to the Treasury and all these other things to go with it, but the loss of interest to the Treasury isn't of primary importance to the individual. The primary importance to the individual is tax reduction, is it not?

Mr. MURRAY. The tax reduction that presumably occurs is because after retirement, when you are no longer earning, you are in a lower tax bracket. And also the Congress has put you in a lower tax bracket by increasing the exemptions after age 65.

A realistic estimate of the revenue loss, in my opinion, and the opinion of other qualified students of the subject, is that in the first full year of operation the revenue loss might reach $75 or $100 million. This estimate may even be high, because it assumes contributions in the range of $200 to $300 million a year.

There is a further reason for emphasizing this time factor in projecting the growth of the utilization of the provisions of H.R. 10. If the Treasury estimate should be correct for some years like 1966 or 1967, or 1968, we should take into account the fact that by then some benefits will start being paid out, and these being fully taxable income, will produce an increasing offset to the so-called revenue loss.

In summary, the American Thrift Assembly, on behalf of its inclusive representation of the self-employed, urges enactment of H.R. 10 as a practical, workable method for removing an inequity to a major segment of our working population. They can be given nearly equal opportunity to save for their retired years without creating any serious disturbance to the revenue position of the Federal Government.

This action, on all accounts, we believe, is long overdue.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. Tell us about the American Thrift Assembly. Do you represent it down here?

Mr. MURRAY. I have for the last half dozen years, on strictly a voluntary basis. I have helped the American Thrift Assembly on certain economic studies.

Senator ANDERSON. You are here, then, at your own expense?

Mr. MURRAY. They reimbursed me for my travel expense. It is my own time.

Senator ANDERSON. Who is the American Thrift Assembly?

Mr. MURRAY. It is an association formed, as I mentioned, of 69 associations of self-employed groups who are banded together. Their only function that I know of has been in support of H.R. 10.

Senator ANDERSON. Do you have a list of the associations?

Senator BENNETT. That was put in the record before you came.

Mr. MURRAY. It is here for the record.

Senator ANDERSON. If it is in the record, that is all right.

Do you know anything about a widespread movement now to permit professionals to incorporate and thus perhaps remove the necessity for H.R. 10?

Mr. MURRAY. Sir, I have been aware of this. And I must confess that it bothers me. In my home State——

Senator ANDERSON. It bothers you?

Mr. MURRAY. It bothers me.

Senator ANDERSON. It is tax avoidance, it ought to interest you.

Mr. MURRAY. My position arises from this, sir. I serve on the Council of Accountancy of New York State, which is one of the organizations appointed by the board of regents to regulate professional activities in the field of public accounting. I feel very strongly on the necessity of personal responsibility for professional people, whether they be accountants, or lawyers, or doctors, or engineers, or dentists, or veterinarians, or funeral directors, or any one of these groups, of which there are so many.

I think it is unfortunate that the discrimination against providing retirement income which now exists is applying pressure toward the incorporation of these kinds of self-employed groups. And this is one of the reasons for my enthusiasm for H.R. 10. I would like to remove two kinds of pressures which I think unintentionally and unfortunately the revenue law now exerts. One is for the self-employed to go to work for somebody else.

And the other, if he doesn't want to do that, to try to incorporate.

I think the tax provisions are distorting the normal, proper, regular functioning of our self-employed people. I think they should be relieved of this pressure to incorporate for tax advantage.

I think it is an artificial, distorting kind of thing that is most unfortunate, and H.R. 10 will relieve this pressure.

Senator ANDERSON. That is a matter of opinion, is it not?

Mr. MURRAY. Sir, I guess with me, after these years of working for H.R. 10, it becomes a matter of conviction.

Senator ANDERSON. Well, a man convinced against his will is of the same opinion still.

Now, the list of States that have been passing these bills is growing rather rapidly: Arkansas, Florida, Georgia, Minnesota, South Dakota, Tennessee, Connecticut, Texas, Ohio, and Oklahoma. And the States where bills were introduced in the legislatures are: Wisconsin, Oregon, California, Alabama, Illinois, Pennsylvania, North Carolina, Indiana, New York and Rhode Island. Would you think the advantage of H.R. 10 is as great as the advantage of the incorporation of professions?

Mr. MURRAY. I suppose there may be a mixing of motives on the part of people who promote this kind of legislation. But I think we do know that the tax provisions, including those relating to retirement income, are a factor. And I know in my own particular case where

I can do something about this, which is in the field of public accounting, we have just gone through a lengthy series of studies. We in our group, who are charged with maintaining professional standards in the public accounting field, have held the line to the last ditch that we will not let accountants incorporate in New York State and practice public accounting.

Senator ANDERSON. There is a bill before the New York Legislature, is there not?

Mr. MURRAY. There have been bills repeatedly for opticians and optometrists and veterinarians, and all that.

Senator ANDERSON. Do we need to get off into optometrists and veterinarians? Isn't it for medical men, ordinary doctors, to incorporate?

Mr. MURRAY. I don't think in New York State they have even tried, because the State is firmly set against permitting doctors to incorporate either directly or indirectly.

Senator ANDERSON. Now, in Ohio the Government said, "We will just sign the bill permitting all professions to incorporate."

And in Oklahoma they passed it, but they didn't allow dentists to incorporate, because dentists were taken care of under social security. Are you sure the bill in New York State didn't take in doctors?

Mr. MURRAY. I am not absolutely positive about that. The bill, as I recall, did not get very far, and, in fact, I was sure it wouldn't pass.

Senator ANDERSON. In Texas the law allowed all professional associations to qualify. And in Nebraska the lawyers are taking a good look at it, because this looks like they can associate themselves together to practice and get all the advantage of corporations.

My point is, why do we have to have H.R. 10 plus this?

Mr. MURRAY. Sir, I think that if they had H.R. 10 the argument for these bills permitting incorporation could be licked. I am opposed strongly, and I think many thoughtful people are, to this kind of trend where you are fostering incorporation in fields where our traditional concept has always been toward personal responsibility.

Senator ANDERSON. Is there anything in this field that would appeal to the question of individuals and corporations being covered by the same procedures?

Mr. MURRAY. My recollection, sir, is that if a man is covered under a corporation plan he is not eligible for participation.

Senator ANDERSON. We had something related to corporations in the bill in the Senate a year or so ago, but it is out of the bill this year in this House.

Mr. MURRAY. The so-called corporate owner-manager provisions which the Treasury introduced and which——

Senator ANDERSON. Which went into the Senate bill, didn't they a year or so ago?

Mr. MURRAY. Yes.

Senator ANDERSON. Are they in the House bill now?

Mr. MURRAY. They are not included in the House bill.

Senator ANDERSON. Do you think that is a good thing?

Mr. MURRAY. I believe that matters relating to the question of the corporate owner-manager are a separate and distinct problem. When Mr. Mortimer Caplin testified last year before your committee, he made a very impressive and clear demonstration to me—and I cer-

tainly regard him as an outstanding expert in this field—that those provisions were separate, distinct, and apart from H.R. 10.

I do not quarrel with the Treasury. If they can show, when they have done the research program which Mr. Surrey said they would contemplate doing, if they can show that there have been abuses in the corporate owner-manager cases under the present law, I would certainly support corrective or remedial action. But this really does not pertain to the problem of the self-employed individual. As a matter of fact, if the Treasury is worrying about the corporate owner-manager provisions, why don't they support H.R. 10 and stop this trend that we have been discussing and which operates in the direction of creating more owner-managers?

This is what we are doing now: we are stimulating the creation of more owner-manager situations which the Treasury finds troublesome.

Senator ANDERSON. We aren't stimulating them. These are the people that know how to get the tax advantages. This American Thrift Assembly that you mentioned, your sponsors, they are a little overlapping, aren't they?

I notice the American Brahman Breeders Association. That is a cattle association?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. American Guernsey Club, is that a cattle organization?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. American Hereford Association, do you think that is a cattle association?

Mr. MURRAY. Sir, as I am sure you appreciate——

Senator ANDERSON. Would you answer the question?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. The American Jersey Cattle Club, do you think that is a cattle organization?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. The American National Cattlemen's Association, do you think that has anything to do with cattle?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. The American Quarter Horse Association, headed by a very prominent cattleman?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. The American Shorthorn Breeders' Association?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. These are all free and independent groups, I am sure.

The American Thoroughbred Breeders' Association?

Mr. MURRAY. Yes, sir.

Senator ANDERSON. The American Veterinary Medical Association?

Senator GORE. I object to the discrimination, you ought to read the Angus Association.

Senator ANDERSON. I saw it at the top of the list just now, the American Angus Association.

Senator Gore probably belongs to it.

72258—61——11

The National Lamb Feeders. Why do they separate the lamb feeders from the National Wool Growers?

Mr. MURRAY. I believe that is because of the individual——

Senator ANDERSON. It is one more name on the list, isn't it?

Mr. MURRAY. Sir, you will appreciate that these self-employed individuals are really individualists——

Senator ANDERSON. You mean the National Lamb Breeders is somewhat different from the rest of these organizations?

Mr. MURRAY. Each association wants to be counted.

Senator ANDERSON. How about the National Live Stock Tax Committee; that is, Mr. Hart, employed by the National Livestock Corp. How is he a separate organization?

Mr. MURRAY. Sir, I am sorry I can't answer the question; I just do not know.

Senator ANDERSON. These are the groups that are behind us. Of course, they are very much interested in doing this as individuals and not as corporations, perhaps, because they have got a fine situation, as I pointed out to you, on the use of the capital gains treatment. But do you think most of these cattlemen have studied H.R. 10 carefully?

Mr. MURRAY. I could not say, sir; I really don't know.

Senator ANDERSON. But you are their spokesman here, aren't you? Who arranges for you do come down?

Mr. MURRAY. The American Thrift Assembly; Mr. Donohue.

Senator BENNETT. I would like to ask the Senator from Tennessee, Are you a member of the National Cattlemen's Association?

Senator GORE. No, sir.

Senator BENNETT. You are a member of the Angus Breeders?

Senator GORE. Yes.

Senator BENNETT. So in your case there is no overlapping on this list.

Senator GORE. Not so far as I know. I wouldn't be surprised, however.

Senator BENNETT. Thank you.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Murray, are you in favor of these national pension plans which you say cover approximately 80 million employees?

Mr. MURRAY. The 80 million covers public and private.

Senator DOUGLAS. You are a student of the private pension plans?

Mr. MURRAY. Yes, sir, I have been a student of them for the past dozen years.

Senator DOUGLAS. In what proportion of these private plans can a worker who leaves the company take away his rights to future pension benefits so far as the contributions of the employers are concerned?

Mr. MURRAY. Sir, I wish I had with me the study that was included in the annual report of the National Bureau of Economic Research a year ago on vesting trends.

Senator DOUGLAS. You are an expert in this field, and I am sure you do not depend exclusively on printed material. Can you give me a rough reply to this? Do you know in what proportion of the private plans a worker who leaves a company can take away his right

to future pension benefits so far as the contributions of the employer are concerned?

Mr. MURRAY. Sir, the reason why I refer to the study, if I might explain, the study which I made, or the people associated with me made, what we constructed, sir, was a percentage expectation——

Senator DOUGLAS. But at the present time what proportion, not a projection, but at the present time?

Mr. MURRAY. At the present time, yes, sir, that is what I was trying to recall.

After 15 years' service my recollection is that the figure was about 45 percent.

Senator DOUGLAS. Prior to 15 years service? Suppose he leaves after 5 years.

Mr. MURRAY. After 5 years, sir, it would only be 5 or 6 percent of the employees that would carry the benefits with them.

Senator DOUGLAS. Is it not true that this very incomplete vesting means in effect that only a relatively small fraction of the employees under private pension plans get pension protection from the contribution of the employers?

Mr. MURRAY. May I have that question again, please?

The CHAIRMAN. Read it, please.

(The question was read by the reporter.)

Mr. MURRAY. Sir, I would say a larger fraction of the—certainly it is a larger fraction of the longtime employees——

Senator DOUGLAS. What proportion of the employees are longtime employees?

Mr. MURRAY. Experience shows, as I believe you know, sir, that the turnover rate drops very abruptly around age 45, which would mean that most of the people employed and covered at age 45 do receive their retirement income, assuming they live. The proportion for men and women working at age 45, I would estimate, would certainly be more than three-quarters. Perhaps a higher proportion of all those who survive—that is, who live to age 65—would receive the benefits.

Senator DOUGLAS. In 20 years—you say only 45 percent would receive benefits on a 15-year basis?

Mr. MURRAY. On the basis of 15 years of service.

Senator DOUGLAS. That is right, in the same company. And that 59 percent who had service of——

Mr. MURRAY. That is because, sir, of the turnover of people starting work at age 20 and leaving before age 35.

Senator DOUGLAS. I understand. Now, then, we come to the question of what proportion of those who serve 20 years would have the right to benefit.

Mr. MURRAY. That has been jumping very rapidly.

Senator DOUGLAS. But how much is it now?

Mr. MURRAY. It would be in the neighborhood of 65, 70 percent.

Senator DOUGLAS. I think these answers indicate that there is an extremely large proportion, let's put it that way, of the employees under private pension plans who, as a matter of fact, do not enjoy pension protection so far as the employer's contributions are concerned, because they cannot meet the test of the prior period of service.

Senator GORE. Will the Senator yield?

Senator DOUGLAS. Yes.

Senator GORE. Until vesting there are no rights at all. As a matter of fact, this is a form of economic peonage.

Senator BENNETT. This is an interesting comment on a very useful inducement for good employees to stay with good employers. This becomes economic peonage.

Senator GORE. I mean, exactly, it is a form of that. An employee who has worked for a certain company for, say, 8 years, and has no vested rights until he remains 15 or 20 years, is economically tied to his job. His welfare is tied there. His desire might be to go to another concern if he could take with him his benefits under this so-called corporate pension plan, but he is unable to do so. Therefore, he is in a sense economically tied to his job.

Senator BENNETT. I am sure there are many motivations, and there are many economic factors involved in the decision to move that are of more importance in most cases than the opportunity of vesting in a pension plan.

Senator GORE. Well, there may be many cases in which these other considerations are not as important. I happen to know some of them.

Senator BENNETT. Well, this business of designating every force you don't like in derogatory terms has always disturbed the Senator from Utah. I am not referring to you as an individual, I am referring to the philosophy that tends to call the pension plan designed for the benefit of the employer economic peonage because it doesn't vest the minute the man becomes a part of it.

Senator GORE. I didn't say that. We weren't talking about the minute. I happen to know of one instance, Senator, in which an employee has been employed for some 15 years by a corporation and he has now reached the age of retirement. He was not employed by that particular concern for a period of 8 days about 8 years ago, and he finds that the corporation pension plan provides that he must have continuous employment. Therefore he is being let out at 65 years of age without one penny of retirement benefits.

Senator BENNETT. You can define individual cases of unfair treatment in any situation. But I don't think you should allow the record to indicate that you think every employer manipulates the pension plan to get rid of the man at age 65.

Senator GORE. I have not made any such inference. If you are going to object to my use of the term "economic peonage," I think you should withdraw the term "unfair".

Senator ANDERSON. Might I get into this?

If you want to get a collection of terms I think somebody should call attention——

Senator BENNETT. Might I just make one comment before you get in?

Three to one against the Republicans is a little more than the usual percentage.

Senator ANDERSON. I was just going to read a clipping which I received today which starts off—

the American Medical Association hit the New Mexico delegation in Congress—and says:

An American Medical Association spokesman has termed a New Mexico's congressional delegation "leftwingers to a man," and says the administration is quoting socialism.

And the author proves this leftwing charge by citing the bills that indicate the leftwing tendency. There were votes in support of the lead and zinc subsidies—he would have the Senator on that, but——

Senator BENNETT. He would have caught me.

Senator ANDERSON. Federal aid to education, increased social security, and a list like that, leftwingers.

So that is worse than talking about peonage.

Senator DOUGLAS. I would like to come back on it, if I may, to the question of the alleged parallels between H.R. 10 and the provisions of the private pension plans.

May I ask you this question. Suppose H.R. 10 is passed, and a person under it pays contributions for 5 years and then decides "I will not pay in the future." Is he or is he not entitled at age 65 to the protection which he has purchased with his 5-year contribution?

Mr. MURRAY. He is fully protected.

Senator DOUGLAS. This will be true not merely on the income which he gained from his personal effort, but also on the income that he derived from ownership?

Mr. MURRAY. Yes, sir.

Senator DOUGLAS. Is it not true, then, that H.R. 10 gives benefits to those who would be insured under it which are not granted in a large proportion of cases to those who are insured under private pension plans?

Mr. MURRAY. To the extent that income other than earned income is included in the present version of H.R. 10, that is correct, sir. This, I believe, is the point that Mr. Keogh was discussing at some length.

Might I just add a footnote to your question on vesting. From my observation, our State and local government plans in many instances require much longer periods of employment before there is any vesting. And I have not found in public plans the trend toward earlier vesting that is clearly visible in private plans.

I am not saying that the separate plans for police, fire, et cetera, are superior, I am not saying that, I am merely comparing the benefits under the private plan with the benefits under H.R. 10. As far as employees are concerned, H.R. 10, with the requirements for vesting, on the whole is more, shall we say, restrictive, or more——

Senator DOUGLAS. George Orwell had a phrase for it, he said:

> All men are equal, but some men are more equal than others.

In other words, H.R. 10 would give equal privileges to those under the private plan, but more equal privileges.

Senator BENNETT. Doctor, isn't it true that if a self-employed individual has more than three employees and thus qualifies under the extra benefits that Senator—the Senator from Tennessee has been worried about, that he must immediately vest the benefits in all of his employees?

Mr. MURRAY. That is correct.

Senator BENNETT. Under this bill, there is no other way he can do it.

Mr. MURRAY. That is correct.

Senator DOUGLAS. Not for these where he has three employees or less.

Mr. MURRAY. But then he is subject to the other limitations.

Senator DOUGLAS. I am simply comparing his benefits to the benefits of employment under the private plan, not the benefits of the employee.

Mr. MURRAY. Sir, of course it is difficult to be precise about these things, because when a company adopts a pension plan as of now, and it has some employees who are aged 60, or something like that, obviously those employees will receive very disproportionate benefits. It is part of the catching up process.

Senator DOUGLAS. Under the accrued liability?

Mr. MURRAY. Yes, under the accrued liability.

Senator DOUGLAS. Do these companies pay them simply their earned amount, or do they meet from their own resources the accrued liability?

Mr. MURRAY. The practice is to meet from company resources the unfunded past service liability.

Senator DOUGLAS. Of course, that is precisely what we do under social security. We provide for our greater benefits to those in the upper age brackets than they contributed.

Mr. MURRAY. That is right.

Senator BENNETT. But, Senator, there is this difference, that under the company pension plans the amount of money to make up the difference comes directly from the stockholders, and under the social security plans it comes in part from the contributions of other social security contributors. There is a very definite difference.

Senator GORE. Doctor, you have made a strong case for the need for passage of H.R. 10 on the ground that it is needed to offset the advantages and the inducements of corporate pension plans. You prefer to give the advantages proposed by H.R. 10 to the so-called self-employed, including investors, rather than to limit and remove the excesses of the corporate plans.

Mr. MURRAY. Sir, I can't quite accept that as a statement of my views, but I think with some modifications I can. I am no proponent of excesses or abuses that may exist in public or private or self-employed retirement benefits. What I am a strong proponent of has been the great development of the retirement income coverage through OASI and through supplemental plans over the years. I think that this has been one of the really fine accomplishments that we can point to with pride in having made a large scale mass retirement income available to such a large segment of our citizens.

Senator GORE. I understand. And you think that, as you have said here several times, and in several different ways, the existence of this situation encourages incorporation of professional people, of small business and otherwise?

Mr. MURRAY. Yes, sir.

Senator GORE. And you don't think it is in the public interest to have this encouragement, and the best way to remove that encouragement is to provide what you described as, I believe, several advantages to the self-employed?

Mr. MURRAY. Yes, sir.

Senator GORE. One of the advantages, the fringe benefits of the corporate form is restricted stock options. You appeared a few days ago and opposed the repeal of that. Since you oppose the repeal of

the present tax treatment of restricted stock options, would it not logically follow that you would favor the development of some sort of tax treatment of investment in partnerships to equate with the tax treatment of restricted stock options?

Mr. MURRAY. I am not entirely clear, sir, on precisely what you have in mind. Are you thinking of a profit-sharing arrangement in relation to partnerships——

Senator GORE. I am thinking of your logic and your position. You have stated several times that you think it is necessary to pass H.R. 10 because of the existence of the advantages of the corporate pension plan.

Mr. MURRAY. That is correct, sir.

Senator GORE. Now, since you oppose repeal of the tax treatment of restricted stock options in corporations for the benefit of the management, would it not logically follow that you favor some similar treatment for the ownership of unincorporated business?

Mr. MURRAY. I suppose my answer to that really is that what we are searching for is some rough kind of equity or equality. You ask me, what can you offer a self-employed individual that is comparable to a stock option as an incentive. And I say, there isn't any. He will get his incentive presumably out of being his own boss and running his own show and not being responsible to someone else. And this is a privilege that many people undoubtedly value more than stock options or group life insurance or accident and health coverage, or a host of fringe benefits provided to employees of Government and private business.

Senator GORE. The goodwill of a business, whether incorporated or unincorporated, is a thing of value, is it not?

Mr. MURRAY. Yes, sir.

Senator GORE. Its tangible value is hard to fix in either event. Would you think that as a rule of thumb a business has a value roughly worth 10 times its well-established annual earning capacity? Do you think that would be a reasonable rule?

Mr. MURRAY. Yes, sir. I think it may vary in different situations, but as a general proposition I think that is reasonable.

Senator GORE. I agree with you. A business which may have capital assets of only $100,000 with an annual earning capacity of $20,000 to $30,000 over a period of years by this rule of thumb would be worth twice its capital value.

Mr. MURRAY. That is right, sir.

Senator GORE. Now, suppose that this business is sold for $200,000, what would be the tax treatment?

Mr. MURRAY. I am assuming, and I guess you are too, sir, that someone had originally invested $100,000, and he sells it for $200,000.

Senator GORE. The undepreciated assets are worth $100,000. But because of the size and the well-established earning capacity, it is reasonably valued at, according to this rule of thumb upon which you and I roughly agreed, for the sake of discussion, and is sold for $200,000. What would be the tax treatment of the proceeds from the sale of that business?

Mr. MURRAY. I believe that would be treated as long-term capital gain.

Senator GORE. Are you sure?

Mr. MURRAY. I will have to consult my expert.

Mr. Rapp counsels me that if you realized just on goodwill, that my answer is correct. If you sold physical assets for more than the cost, it might be different, if you sold inventory, something like that, stock in trade.

Senator GORE. I will not persist in it. What I was trying to suggest to you, Doctor, is that there are comparable situations with respect to values of a partnership and a corporation. True, there are instances in which they are not comparable. But what I am trying to point out really is that by the force of your logic, because there is one provision in the law which offers an inducement to taxpayers, we must create another provision in the law to offset that inducement. I am trying to point out that in my opinion that is bad reasoning.

In other words, one wrong cannot justify another, nor can one inequity or one advantage justify the other. We must seek to apply the yardstick of fairness to all taxpayers.

Now, this is a Member of the Senate speaking. I would hope that you would teach such principles at Columbia.

Mr. MURRAY. Sir, I do my best to teach precisely those principles of fairness and equity.

Senator GORE. Thank you very much, sir.

The CHAIRMAN. Thank you very much, Dr. Murray.

The next witness is Gerhard A. Munch, American Life Convention, Life Insurance Association of America, Life Insurers Conference, and the National Association of Life Underwriters.

STATEMENT OF GERHARD A. MUNCH, ON BEHALF OF AMERICAN LIFE CONVENTION, LIFE INSURANCE ASSOCIATION OF AMERICA, LIFE INSURERS CONFERENCE, AND THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS; ACCOMPANIED BY THAXTER P. SPENCER, ASSISTANT SECRETARY AND MANAGER, PENSION DEPARTMENT, NEW ENGLAND MUTUAL LIFE INSURANCE CO.

Mr. MUNCH. My name is Gerhard A. Munch, assistant general counsel of the Mutual Life Insurance Co. of New York, but I appear today on behalf of the four trade associations who represent the life insurance industry.

And on my left I have with me Mr. Thaxter P. Spencer, the assistant secretary and manager of the Pension Department, New England Mutual Life Insurance Co.

Senator BENNETT. Mr. Munch, is your testimony fairly technical?

Mr. MUNCH. It is.

Senator BENNETT. It is on the proposed amendment to the bill and not on the basic philosophy behind the bill?

Mr. MUNCH. That is correct, sir.

Senator BENNETT. I wonder if you couldn't offer it for the record. The chairman and I are the only two here to actually hear the sound of your voice, so I wonder if you could just offer it for the record and then in a minute or two tell us the reason why you think these technical amendments are needed. Then we can study the details of your amendments.

Mr. MUNCH. I certainly can do that, Senator. It just went through my mind that I could cover the two points, the two initial points

which are the important ones, very quickly, and then I could offer the rest of the statement for the record, but if you prefer, I can offer the statement for the record without speaking on these two points.

Senator BENNETT. Go ahead on the two points, if you think they are important.

Mr. MUNCH. Of the four associations, the American Life Convention, the Life Insurance Association of America, and the Life Insurers Conference are three associations with an aggregate membership of 343 life insurance companies in the United States and Canada which have in force approximately 96 percent of the legal reserve life insurance written in the United States.

The National Association of Life Underwriters is an association having a membership of 80,000 consisting principally of life insurance agents, general agents, and managers located in all 50 States, the District of Columbia, and Puerto Rico.

Our associations believe, as we have stated on other occasions before this committee, that the individual initiative of our citizens in providing for their retirement should be encouraged. We therefore favor the basic principles of H.R. 10, the self-employed individuals tax retirement bill.

The bill now before us differs in many respects from previous bills bearing the same title and number. There were no hearings on this bill in the House. It was considered there under a procedure which limited debate and provided no opportunity for necessary amendments. Hence, it is doubly important that omissions and oversights almost inevitable in any such new legislation be called to the attention of your committee.

We have two points which concern primarily the use of life insurance and annuities as a funding method under the bill. In addition, we should like to discuss five other points, all of which relate to retirement plans in general, however funded.

With your permission, I will just discuss the first two points, and submit the remainder.

Senator BENNETT. Your whole statement will be included in the record as though you had read it word for word, in addition to the words that you utter now. So that unless you feel it is necessary, there is no reason to repeat what we will already have in the record.

(The statement referred to follows:)

STATEMENT OF GERHARD A. MUNCH ON BEHALF OF AMERICAN LIFE CONVENTION, LIFE INSURANCE ASSOCIATION OF AMERICA, LIFE INSURERS CONFERENCE AND THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, JULY 25, 1961

Mr. Chairman, I am Gerhard A. Munch, assistant general counsel of the Mutual Life Insurance Co. of New York. I appear today on behalf of four trade associations representing the life insurance business.

The American Life Convention, the Life Insurance Association of America, and the Life Insurers Conference are three associations with an aggregate membership of 343 life insurance companies in the United States and Canada which have in force approximately 96 percent of the legal reserve life insurance written in the United States. The National Association of Life Underwriters is an association having a membership of 80,000 consisting principally of life insurance agents, general agents, and managers located in all 50 states, the District of Columbia, and Puerto Rico.

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We have two points which concern primarily the use of life insurance and annuities as a funding method under the bill. In addition, we should like to discuss five other points, all of which relate to retirement plans in general, however funded.

As regards our first two observations, it should be kept in mind that the bill seeks to encourage the establishment of voluntary retirement plans by the self-employed. A wide range of funding media would qualify for that purpose under the present language of the bill. Life insurance, endowment and annuity contracts are specifically included. However, the two provisions of the bill which I am about to discuss make it extremely doubtful that individual contracts, as presently approved and issued under State insurance regulation, could be utilized effectively for this purpose by self-employed persons. Yet the life insurance business, with its wide experience in providing retirement benefits, is eminently qualified to provide the very protection and safeguards so essential to a sound retirement program.

1. *Prohibition of excess contributions.*—The provisions of the bill most detrimental to the use of individual annuity, endowment, or life insurance contracts are those prohibiting contributions for owner-employees in excess of the amounts which are deductible (proposed sec. 401(d)(6) and 401(e)). These provisions would jeopardize the use of such contracts as a funding mechanism in the following manner: Incomes of the self-employed, unlike salaries of employees, are subject to wide fluctuations from year to year. With the deduction under this bill primarily measured by income, the allowable deduction for owner-employees will fluctuate in like manner. This presents no problem for those utilizing other funding media. They merely would gear each year's contribution to their current self-employment income. Thus, should they so desire, they could readily obtain the maximum deduction each year.

On the other hand, individual life insurance and annuity contracts generally are available only on a "level premium" basis; that is, the amount of the periodic consideration for them remains constant. It cannot be varied from year to year. Hence, to avoid disqualification, an owner-employee would have to select a contract for which the periodic consideration is not likely to exceed the deductible portion of his lowest expected annual income. To make such a selection is hardly feasible. A single year of inadequate income is apt to defeat his retirement plan.

The fact that the level premium may from time to time exceed the statutory limits on deductibility should not cause the plan to fail. It should be enough that the deduction actually available to the owner-employee is restricted to the statutory limits. In fact, the logic of this position has already been recognized by the present bill in its treatment of qualified Government bond purchase plans. In discussing these plans, the report of the House Ways and Means Committee states at page 12:

"The amount deductible is to be determined in the same manner as if the cost of the bond were a contribution to a qualified retirement trust, except that the special rules relating to excess contributions in the case of owner-employee type plans do not apply. Those rules are considered inappropriate to qualified bond purchase plans not only because the special bonds might be purchased by anyone (and not solely for retirement purposes), but also because the denominations in which the bonds might be issued will not necessarily bear any relation to the amount which might be deducted by an owner-employee."

The identical logic applies to life insurance, endowment, and annuity contracts, and they should be accorded the same treatment.

It might be argued that life insurance companies could develop individual policies with variable premiums to meet the provisions of this bill. Even if possible, however, the development of such policies and the securing of the necessary approvals by the various State regulatory bodies would consume a considerable amount of time, perhaps several years. That would place the life insurance business at a serious competitive disadvantage.

We therefore urge that the bill be amended so as to enable all self-employed individuals to utilize life insurance, endowment, and annuity contracts for their qualified retirement plans, even though the fixed premiums therefor may exceed the amounts deductible. By this we do not suggest any expansion of the deductible amounts now provided in the bill.

2. *Bank trustees for insured plans.*—Another serious deterrent to the use of life insurance contracts is the requirement of proposed section 401(d)(1) that the trustee of a qualified trust be a bank whenever an owner-employee participates in the plan.

Presumably the purpose of this requirement is to assure independent management so as to prevent misuse of the trust funds for the benefit of the participating owner-employee. However, in the case of a qualified trust which places all of its funds in life insurance contracts, or in such contracts and related auxiliary funds administered by a life insurance company, no additional independent management by a bank trustee is necessary. In such case the trustee has no discretion in the use of the fund. The plan calls for the investment of the funds with the insurance company, and the trustee—acting merely as a conduit—may not apply the funds to any other use. Thus the insurer performs the very functions sought to be accomplished by this requirement.

In such circumstances the added expense of having to interpose a bank as trustee seems wholly unwarranted. This is particularly serious in the case of the pension plan of a small business, where the additional expense of a corporate trustee is necessarily greater in proportion to the cost of the plan benefits provided.

We therefore recommend that proposed section 401(d)(1) be amended to remove the requirement of a bank trustee in the case of insured plans of this type.

I turn now to the five remaining points. As I mentioned at the outset, these points affect all pension plans regardless of the funding method used.

3. *Final distributions to beneficiaries under pension plans.*—Proposed section 401(a)(8) would require that distributions under a qualified trust be made in the case of an owner-employee by age 70½, and in the case of other employees by age 70½ or retirement age, whichever is later; or if distributions are to be made over a period of time, the payments must commence within the taxable year so specified and may continue only over the life of the employee and his spouse or over their life expectancies. This provision is one of several which would be made applicable to all qualified trusts, not just those affecting owner-employees.

The basic purpose of this provision is to prevent unreasonably long deferral of income. It goes much too far in this direction, however, and in doing so would require the amendment of thousands of existing plans. Two observations are pertinent.

First, proposed section 401(a)(8)(B), dealing with periodic payments, fails to provide adequately for payments over a specified number of years. Payment of benefits over a fixed number of years, or for life with a guaranteed minimum number of payments, is widely favored and is recognized as proper under section 72 of the code and the regulations thereunder. Generally, these term certain payments fall approximately along the same period as the life expectancy but there is no certainty that they will coincide.

Second, and perhaps more important, the bill ignores the needs of beneficiaries other than spouses. It is proper, and in keeping with the spirit of this bill, to permit the individual, who best knows the needs of those who depend on him, to designate the recipient of survivor benefits, so long as there are ample safeguards against unreasonable deferral.

We recommend therefore that section 401(a)(8) be amended to permit payment over the life or life expectancy of the employee and his beneficiary, who must be a dependent, or over a period of 15 years, whichever is the longer.

4. *Coverage requirements.*—The bill provides in proposed section 401(a)(10) that a trust which includes owner-employees "shall be a qualified trust under this section only if each employee having a period of employment of 3 years or more is included under the plan."

Present section 401(a)(3) of the code permits reasonable classifications of employees for coverage purposes. Section 401(a)(3)(A) provides, among other things, that the length-of-service requirement for coverage must not exceed 5 years. Very clearly the present bill would reduce this 5-year maximum to 3 years in the case of owner-employee plans. Section 401(a)(3)(B) allows other

classifications so long as they are not discriminatory, and on this basis many qualified plans cover only those employees who have attained a specified age. Though there is no apparent intent in the bill to deny such classifications based on attained age, this should be made clear.

We believe that it is desirable to allow some leeway for qualified plan coverage based upon attained age. The young employee under age 25 or 30 is unlikely to find such plan coverage an attractive part of his compensation picture. A permissive minimum age requirement would eliminate the necessity of bringing into the plan younger people in their late teens or early twenties where most terminations of employment can be expected. For example, many young female employees just out of school marry at an early age and permanently leave the labor market. Their accumulations under an employee plan would be too small to provide any real retirement benefits, and if such plans were vested the likelihood is that the savings would be withdrawn rather than used for retirement purposes.

We recommend that the bill be amended to make clear that it does not deny reasonable classifications based on attained age, as now permitted under section 401(a)(3).

5. *Vesting.*—Proposed section 401(d)(3) would require in the case of owner-employee plans that contributions on behalf of nonowners be vested when made. Despite the arguments in favor of vesting, it must be realized that immediate vesting increases materially the cost of providing retirement benefits. The necessary result is to reduce the amounts which many small employers would otherwise be able to provide for their employees who continue in service to retirement age.

6. *Distribution of death proceeds.*—Proposed section 401(d)(7), literally read, appears to require that in the case of an owner-employee distribution must be made within a specified time after his death or that of his spouse if she survives him. Such distribution must be completed within 5 years or the proceeds applied to the purchase of an immediate annuity. Apparently through oversight, the bill makes no provision for continuation of retirement payments already commenced under a term certain annuity. The apparent effect is to force the purchase of a completely new annuity without permitting the continuation of an existing term certain annuity, certainly a result not intended here.

We recommend that this section be amended to permit the continuation of payments to the beneficiary rather than forcing the purchase of a completely new annuity.

7. *Distribution under bond purchase plans.*—In its present form the bill contains an obvious discrimination in favor of Government bond purchase plans. Proposed section 401(a)(8) would basically provide that the interest of an employee must be distributed by age 70½ or commencing at that time. Generally such distribution would be immediately taxable to the extent received. In the case of qualified bond purchase plans, however, section 405(d)(1) would provide that upon distribution no tax is realized. Thus, although under other types of funding taxable payments to the employee must commence by age 70½ or retirement age, the bond might be held tax free for any length of time without subjecting the distributee to tax.

We believe that if Government bonds are to compete with other funding media in this field, they should not be accorded more favorable tax treament.

I appreciate this opportunity of appearing before your committee on this important legislation. If there is further information we can furnish to the committee on this subject we will be glad to do so. We will also be happy to offer legislative language to implement the recommendations we have made, if the committee or the staff would like to have it.

Mr. MUNCH. Well, I will attempt to summarize the first two points. The first point relates—and I have to be necessarily rather broad, and I stand on my statement—to the prohibition against excess contributions. Our point is that these provisions would actually exclude from consideration as an investment medium the use of life insurance annuities. The reason for that is that, especially individual contracts, life insurance annuities, and endownment policies, are written on a fixed premium or fixed annual contribution basis.

Now, unlike an employee who can pretty much foretell what his salary or wages will be in the future, and they are apt to raise rather than go down, the self-employed earnings are apt to fluctuate.

Now, let's take the very example Senator Curtis gave the other day of the three types of men, an employee covered by a qualified plan, a self-employed man, and an employee not covered by a qualified plan, all earning $10,000 from 40 to 60. That may be a good assumption for an employee, but the self-employed man does not know that.

Suppose he made $10,000 in the last few years, he could commit himself to 10 years for an insurance contract or annuity in the amount of $1,000, and 1 year of less than $10,000 earnings would knock him out. He still has to meet his commitment, a $1,000 premium, but if he does pay, he has made an excess contribution, and it has to be returned.

Well, it cannot be returned under the contract.

Now, our suggestion is that certainly the premium that is traditionally used for providing retirement income, meaning life insurance company contracts, should not be excluded by this requirement. And we feel the inducement to set up a retirement program is obviously the deductibility of the contribution, or the premium in this case.

It seems to me that the average man is not apt to tie up his funds required by the bill for so many years if he cannot get that deduction. So our proposition is merely is, let him make his commitment, but he cannot deduct more than the limits of the bill.

That in essence is our point.

The other point is, the bill now requires that in the case of trusteed plans the trustee must be a bank if the self-employed is included in the plan. We suggest that if the plan is funded entirely 100 percent with insurance company contracts to a trustee, but the trustee puts all the funds in an insurance company contract, or an accelerated fund administered by the life insurance company, the fears that these provisions try to cover would be unfounded, because certainly the life insurance company is just as capable of administering these funds without abuse as a bank is.

Another point is that in many small communities there are no banks that have trust facilities of this type.

Now, the interposition of the banker trustee in this type of plan would merely increase the cost, particularly for the small businessman who likes to take advantage of this bill.

Now, Senator, these are, in a very abbreviated way, our points.

The CHAIRMAN. Thank you very much, Mr. Munch. I hope you understand why we were so restricted in time.

Senator BENNETT. Are you going to propose amendments, language of the amendments, which would create the situation that you think——

Mr. MUNCH. We should be very glad to have our staff people sit down with your staff to work out these amendments. I am sure they can be worked out. We have no specific language at this point.

The CHAIRMAN. I wish you would present those to the committee as soon as they are drafted.

Mr. MUNCH. Thank you.

(The amendments subsequently submitted appear on p. 185.)

The CHAIRMAN. The next witness is Mr. Leonard L. Silverstein, Investors Diversified Services, Inc.

STATEMENT OF LEONARD L. SILVERSTEIN, INVESTORS DIVERSIFIED SERVICES, INC., AND INVESTORS SYNDICATE OF AMERICA, INC.; ACCOMPANIED BY STANLEY OZARK, TAX COUNSEL

Mr. SILVERSTEIN. Mr. Chairman and Senator Bennett, my name is Leonard L. Silverstein. I am an attorney of Washington, D.C., and appear here today on behalf of Investors Diversified Services, Inc., and Investors Syndicate of America, Inc., its wholly owned subsidiary. I am accompanied by Mr. Stanley Ozark, who is tax counsel for Investors Diversified Services, Inc. I would like also to state that Investors Diversified Services and Investors Syndicate of America both wholeheartedly support the principles of H.R. 10. These organizations are investment companies with principal offices located in Minneapolis, Minn. Investors Syndicate of America, Inc., is engaged in the business of issuing face-amount certificates. Face-amount certificates are investment contracts which are purchased with a lump-sum payment or with periodic payments over a stated period of time. At maturity the certificates enable the investor to receive the face amount, which can be paid to him either in a lump sum or periodically. The certificates are registered under the Investment Company Act of 1940, and are offered for sale, after registration, with the Securities and Exchange Commission, pursuant to the Securities Act of 1933. These certificates present one acceptable means of providing for the benfits retirement program contemplated in H.R. 10.

The problem to which I wish to address myself today concerns a restriction on their use for purposes of H.R. 10, which restriction was added, apparently for technical reasons, at the request of the Treasury and during the executive sessions of the Ways and Means Committee concerning the bill. The restriction took the form of an amendment which would permit face amount certificates to qualify for use in connection with H.R. 10 retirement programs, but only if the face amount certificates are nontransferable. The apparent reason for addition of this restriction is to insure that aparticipant in the H.R. 10 program will not be permitted to dispose of his certificate once he has deducted the cost of purchasing such a document. Investors Syndicate of America, Inc. has no quarrel with this restriction so long as the restriction is uniformly applied to all forms of investment having a similar effect as face amount certificates.

It has come to the attention of Investors Diversified Services, Inc. that it is possible for insurance companies to issue annuities for a term certain, the conditions of which are exactly the same as the face amount certificates issued by Investors. Under the bill in its present form, however, no nontransferability limitation applies to a document which constitutes an annuity but which is not a face amount certificate. Unless the nontransferability feature is applied across the board to annuities, as well as face amount certificates, it is obvious that a serious and unintended discrimination can result in practice.

I hand herewith to the committee a sample certificate issued by Investors (together with a sample annuity issued by a private insur-

ance company for substantially the same terms except that under H.R. 10 the annuity would be transferable and the face amount certificate would not have this privilege). I am submitting technical language to accomplish this result and will be glad to discuss the problem with the staff of the joint committee and other appropriate officials.

A further point which I desire to call to the committee's attention relates to the provision relating to custodial accounts contained in section 2(3)(f) of the bill. Under that provision, custodial accounts consisting entirely of mutual fund shares can qualify as a trust. Such custodian, however, must be a bank as defined under section 581 of the code. Under the section 581 definition, an organization must not only be subject to supervision by State or Federal banking authorities, but must also be "named" (apparently in common parlance) as a bank or trust company.

Investors Diversified Services, Inc. is subject to supervision by the banking authorities of the State of Minnesota but is not commonly known as a bank, although it is fully equipped to carry on custodial functions contemplated in H.R. 10. This capacity on the part of Investors Diversified Services, Inc., is already recognized in H.R. 10 in connection with formal trusts, pursuant to section 2(3), page 8 of the bill. For this reason, it is suggested that the committee give consideration to eliminate—for custodial purposes as well as for trust purposes—the purely semantic aspects of the definition, making it applicable to all organizations subject to Federal or State banking supervision, as H.R. 10 now provides in section 2(3) on page 8 in connection with formal trusts.

A draft to accomplish this result is attached.

Thank you for this opportunity to appear.

I should add finally that there are two exhibits. The principal technical point raised relates to the difference between the investors contracts and the annuities offered by insurance companies. And we are asking for equivalent treatment in the bill. And we have samples of each of the contracts which demonstrate it. And we would like to submit those for the record as well.

The CHAIRMAN. Give those to the staff.

(The supplemental statement and samples of contracts submitted by Mr. Silverstein follow:)

SUPPLEMENTAL MEMORANDUM TO STATEMENT OF LEONARD L. SILVERSTEIN ON BEHALF OF INVESTORS DIVERSIFIED SERVICES, INC., AND INVESTORS SYNDICATE OF AMERICA, INC.

Mr. Chairman and members of the committee, my name is Leonard L. Silverstein. I am engaged in the practice of law in the District of Columbia and appear before you on behalf of Investors Diversified Services, Inc., and Investors Syndicate of America, Inc., its wholly owned subsidiary. Both corporations are face amount certificate companies as defined in section 28(a) of the Investment Company Act of 1940 (15 USCA 80a-28).

The purpose of this memorandum is to supply background for the committee's attention of the two technical and seemingly unimportant matters concerning H.R. 10, as to which oral testimony has previously been rendered, and which will cause widespread and, doubtless, unintended hardships. These technical matters relate to face amount certificates and custodial accounts for stock of regulated investment companies.

FACE AMOUNT CERTIFICATES

Face amount certificates are investment contracts which are purchased with a lump sum payment or with periodic payments over a stated period of time. At maturity the certificates enable the investor to receive the face amount, which can be paid to him either in a lump sum or periodically. The certificates may be sold only by face amount certificate companies registered under the Investment Company Act of 1940. Furthermore, the certificates cannot be offered for sale until they have been registered with the Securities and Exchange Commission under the Securities Act of 1933. The certificates must also be registered, or otherwise qualify for sale in the States in which they are offered.

Under the Investment Company Act of 1940 the types of investments which may be made by face amount certificate companies are described. Most of the face amount certificates require such a company to make a deposit or deposits of eligible assets equal to the amount of the company's liability. The Commission has also prescribed methods of evaluating such assets.

A copy of a typical face amount certificate is attached for examination.

It can easily be seen that face amount certificates perform functions that are virtually identical with the functions performed by annuity contracts, particularly annuities for a term certain. These certificates provide for accrual of a retirement fund over a period of years and the distribution of the fund to the holder of the certificate during his retirement years. Not only is there an identity between annuities and face amount certificates, but face amount certificates have the added protection of Federal regulation. While performing the same function as annuities, face amount certificates have a financial soundness that is as great as or greater than annuities. A review of Investors Syndicate of America's activities for 1960 shows that categories of purchases involved a variety of gainful occupations, headed by educators and include many others:

20 leading occupations in number of all ISA certificates

Occupation	Total number	Percent of total number
1. Educator	5,006	11.24
2. Food and kindred items	1,919	4.31
3. Gasoline and oil products	1,717	3.85
4. Farmer	1,709	3.84
5. Other retail and wholesale outlets	1,541	3.46
6. Miscellaneous manufacturers	1,311	2.94
7. Eating and drinking places	1,229	2.76
8. State and municipal employees	1,071	2.40
9. Physician	949	2.13
10. Auto sales and equipment	902	2.02
11. Building trades	900	2.02
12. Transfer and storage	882	1.98
13. Garage and auto repair	875	1.97
14. Food and kindred products	858	1.93
15. Metal industries	840	1.89
16. Clergyman	840	1.89
17. Army and Navy	826	1.85
18. Federal employees	812	1.82
19. Barbers and beauticians	757	1.70
20. Housewife (with independent income)	700	1.57
Total	25,643	57.57

This description of face amount certificates and their relationship to annuities is necessary to fully understand the chronology of the treatment of face amount certificates in H.R. 10, as the bill was considered by the House Ways and Means Committee and by the full House. When H.R. 10 was first introduced by Congressman Keogh in the House of Representatives during this session, section 2(3)(g) of the bill provided that the term, annuity, includes a face amount certificate. Because of the similarity between the two types of investments, the reason for their identical treatment is obvious.

The House Ways and Means Committee considered H.R. 10 in executive session and, without public hearings reported out the bill with "technical amend-

ments." One of the technical amendments provided that the term annuity includes a face amount certificate "which is nontransferable." This seemingly unimportant technical amendment, which the full House accepted as part of H.R. 10 when it passed the bill, destroys the identity of treatment between annuities and face amount certificates. In effect, transferable annuities will qualify under H.R. 10, although transferable face amount certificates will not.

Aside from the clear logic of treating annuities and face amount certificates in the same manner, it would seem that a sense of equity and fair play would demand the same result. It is an obvious economic fact that issuers of face amount certificates and issuers of annuities are in direct competition in the same market. No purpose could be served by differentiating between the commodities on the basis of transferability unless it would be the purpose of penalizing the issuers of face amount certificates. There is no warrant for even intimating that this was the congressional purpose for the "technical amendment."

It is the understanding of Investors Syndicate of America, Inc., that some question exists as to the ease with which face amount certificate holders can transfer their certificates prior to the time limitations which are provided under the basic provisions of H.R. 10. One argument advanced is that since annuity certificates can only be transferred on the books of the issuing company, there would be no problem in discovering which annuities are transferred prior to the legislative time period. However, face amount certificates contain a clause which provides that they cannot be transferred without the issuing company's written consent. Article 17 of the sample face amount certificate contains such a clause. It cannot be validly contended that it will be easier to discover, from the records of the issuing annuity company, which person has transferred annuities prior to the time limitation set forth in H.R. 10, than it would be to discover the comparable information from the written consents in the records of the face amount certificate companies.

Another argument that is proposed in support of different treatments for face amount certificates and annuities is that the only type of annuity subject to transferability is an annuity for a term certain and that life expectancy annuities are not normally transferred between taxpayers. From this premise the argument continues—term certain annuities are not issued by insurance or annuity companies. Therefore, since the only type of annuity that is commonly issued, i.e., life expectancy annuities, are not normally transferred, there is no problem with respect to the transferring of annuities. The assumption that term certain annuities are not issued is not correct and has been refuted by a knowledgeable attorney with extended experience in the insurance business.[1] Furthermore, even if term certain annuities were not in existence, the transferability problem with respect to annuities does not disappear. Investors Diversified Services understands that as recently as 1958 there were a number of companies in New York and Chicago which traded in life expectancy annuities.[2] The fact that transferring of such annuities has taken place in the past is illustrated by the cases of *Commissioner* v. *Phillips*,[3] and *Arnfeld* v. *United States*[4] which concerned the sales of annuities and endowment policies prior to maturity, in the expectation the seller would derive capital gains rather than ordinary income. Although the courts held for the Government on the capital gain—ordinary income issue, the fact remains that annuities contracts are susceptible to being transferred, and, where a sufficient sizable tax benefit might be gained, will be transferred.

Since the transferability distinction between face amount certificates and annuities is entirely illusory, there would seem to be no warrant to make an arbitrary distinction which will provide competitive advantages to annuity companies that they would otherwise not enjoy under the far more equitable interplay of the marketplace.

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[1] See Johnson, "The Variable Annuity—Insurance Investment, or Both?" 48 Georgetown Law Journal 641, 653 (1960).
[2] See Wiley, "The Sale of an Endowment Policy," 36 Taxes 803 (1958).
[3] 275 F. 2d 33 (4th Cir. 1960).
[4] 163 F. Supp. 865 (Ct. Cl. 1958).

However, Investors Syndicate of America, Inc. does not urge that the committee adopt a policy of permitting the transfer of annuities and face amount certificates; it can well understand that this committee may want to eliminate any possibility of anticipatory transfers of investments which qualify under H.R. 10. If this is the congressional purpose, then all annuities and face amount certificates which qualify under H.R. 10 should be required to be nontransferable. The competitive imbalance would then disappear and annuities and face amount certificates would gain public acceptance in accordance with the intrinsic benefits and advantages.

There is submitted with this statement a proposed amendment to section 2(8)(g) of H.R. 10 which will accomplish such a nondiscriminatory result.

CUSTODIAL ACCOUNTS FOR REGULATED INVESTMENT COMPANY STOCK

There is no need to describe regulated investment company stock in the detail utilized with respect to face amount certificates. Regulated investment companies or mutual funds, provide a security through which an investor can obtain wide investment diversification. In section 2(8)(f) of H.R. 10 as passed by the House, it is provided that custodial accounts, if they are composed entirely of mutual fund shares, can qualify as trusts under the normal provisions of H.R. 10. However, it is further provided that the custodian must be a bank, as defined in section 581 of the Internal Revenue Code. Under that section a bank is generally defined as a bank or trust company which is subject to supervision by State or Federal banking authorities.

It is evident on its face why Congress would require, as a custodian or trustee, an institution which is subject to the supervision of banking authorities. However, local banking authorities often supervise institutions other than those which might be narrowly considered a bank. No reason is provided in the report of the Ways and Means Committee accompanying H.R. 10, why a distinction should be drawn between a bank or any other institution, provided that both types of institutions are subject to banking regulation. In fact, the immateriality of such a distinction is recognized in H.R. 10 which provides that the trustee of a pension or profit-sharing trust which benefits owner employees may be any corporation that is subject to supervision of a State banking commission. This provision is contained in proposed section 401(d)(1)(B), on page 8 of the bill reported out by the House Ways and Means Committee. In fact, the committee report, in explaining proposed section 401(d)(1)(B) indicates that there should be no distinction between a bank or other institution. On page 20 of that report the committee states:[8]

"Paragraph (1) of the new subsection (d) provides that, in the case of a trust which is created on or after the date of the enactment of the bill, or which was created before such date but is not exempt as a qualified trust on the day before such date, the trustee must be a *bank*." [Emphasis supplied.]

The Ways and Means Committee by its use of the word "bank" to describe both an institution which may be technically considered a bank and any other type of institution supervised by a State banking authority, indicated that there was no real difference between the two institutions, at least with respect to H.R. 10 policy considerations.

Investors Diversified Services, Inc., would urge that this committee remove what is, at most, a semantic distinction, by providing that custodial accounts as well as pension and profit sharing trusts can be managed by any corporation that is validly supervised by State or Federal banking authorities. There is submitted herewith proposed language which will accomplish this purpose.

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[8] H. Rept. 378, 87th Cong., 1st sess. (1961), p. 20.

PROPOSED AMENDMENTS TO H. R. 10 SUBMITTED BY INVESTORS DIVERSIFIED SERVICES, INC., AND INVESTORS SYNDICATE OF AMERICA, INC.

On pages 20-21, add the italicized material to section 2(8)(g) as follows:

"(g) FACE AMOUNT CERTIFICATES TREATED AS ANNUITIES.—For purposes of this section and sections 402, 403, 404, the term 'annuity' includes a face amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a-2), which is nontransferable, *but does not include any transferable contract issued by any insurance or investment company.*"

Pages 19-20, amend section 2(8)(f) as follows (existing language proposed to be omitted is enclosed in black brackets, new matter is italic):

"(B) the custodian is a bank (as defined in [section 581] *section 401(d)(1)(B)*;".

I hereby certify that the following instrument consisting of five pages is a sample copy of a contract which has been issued by an American life insurance company which operates in a large portion of the United States.

E. M. Burke

E. M. Burke, General Counsel

Investors Syndicate Life Insurance and Annuity Company
Minneapolis 2, Minnesota

Dated July 27, 1961

Contract Number

Contract Date Mo. Day Year 19 Age

Monthly Income $

Maturity Date Mo. Day Year Maturity Value $

Annuitant

Owner

Beneficiary

Premiums: Annual Semi-Annual ______ Quarterly ______

Amount $ $ $

Payable each year for fifteen years or until the prior death of the Annuitant.

Life Insurance Company hereby agrees to pay the Monthly Income shown above to the Annuitant if living on the Maturity Date, the first payment to be made on the Maturity Date and subsequent payments monthly thereafter until payments for fifteen years in all have been made; or, immediately upon receipt of due proof of the death of the Annuitant prior to the Maturity Date, the Company agrees to pay a sum equal to all premiums on an annual basis for the period for which premiums have been paid or the tabular cash value at the end of the policy year in which death occurs, whichever is greater, to the designated beneficiary.

This polic, is issued in consideration of the application therefor and of the payment of premiums as herein provided.

The provisions on this and the following pages hereof form a part of this policy.

Executed at the Home Office of the Company at as of the Contract Date.

Secretary President

Countersigned ______________________
Registrar.

15 Payment Deferred Annuity – Maturing in Years
Monthly Income at Maturity – Return of Premiums or Cash Value at Prior Death
Annual Dividends

73258 O—61——13

Participation

This is a participating policy. The Company will annually determine the divisible surplus and, beginning at the end of the first policy year, ascertain and allocate to this policy, as a dividend, its equitable share.

On the death of the Annuitant, such dividend as may be allocated will be credited to this policy for the fraction, if any, of the then current policy year elapsed before such death.

Dividend Options

While this policy is in force on a premium paying basis the dividends may be applied under one of the following options:

Option 1. Applied toward the payment of the premium, if any then due, provided the balance of the premium is paid; or

Option 3. Paid in cash; or

Option 4. Left to accumulate at interest, with privilege of withdrawal in cash at any time if not required as security for a loan or applied under the Non-forfeiture [illegible]; dividends so left to be credited annually with interest at the rate determined by the Company, but in no event less than 2¼ per cent, and if not withdrawn will be added to the proceeds at death.

Unless otherwise elected in writing, dividends declared during the premium paying period shall be paid in cash. A new dividend option under which future dividends will be applied may be elected at any time during the premium paying period.

After the premium paying period, if all premiums have been paid when due, dividends as declared from year to year together with any dividend accumulation under Option 4 above at the end of the premium paying period shall be left to accumulate at such rate of interest as the Company may from year to year declare on such funds, but in no event less than 3 per cent a year. Such accumulated dividends shall be added to the proceeds at death, maturity, or upon surrender of the policy.

Monthly Income to Annuitant

If the Annuitant is living on the Maturity Date and the Monthly Income payments shown on the face of the policy commence, income payments will be made monthly thereafter until payments for fifteen years in all shall have been made or until the prior death of the Annuitant. If the Annuitant shall die before income payments for fifteen years shall have been made, the unpaid payments for the balance of fifteen years commuted at the rate of 2¾ per cent a year compound interest shall be paid in one sum to the designated beneficiary or beneficiaries, their survivors or survivor, if any, otherwise to the executors or administrators of the Annuitant.

The Monthly Income shown on the face of this policy is based on the Maturity Value. If there be any indebtedness to the Company at the Maturity Date on account of this policy the Monthly Income shall be reduced in the proportion which the indebtedness with interest thereon bears to the Maturity Value. Such Monthly Income shall be increased in the proportion which the total amount of any dividend accumulations bears to the Maturity Value.

Instead of the Monthly Income provided on the face of this policy, election may be made, at any time before the Maturity Date, to receive at the Maturity Date a single cash payment of the Maturity Value plus the amount of any dividends left to accumulate at interest and minus any indebtedness on the policy.

Control of Policy

Ownership

Ownership of this policy vests in the Annuitant in the absence of designation of some other Owner in the application for the policy, or in the policy or in an endorsement by the Company thereon. Provided, however, if this policy is issued on the life of a minor and is applied for by a Recognized Applicant, ownership vests successively (a) in the Recognized Applicant until his death or the prior attainment by the Annuitant of age 21, (b) if Recognized Applicant's ownership is terminated by his death, in the Contingent Recognized Applicant, if any, until his death or the prior attainment by the Annuitant of age 21, (c) in the Annuitant; provided that either the Recognized Applicant or Contingent Recognized Applicant, while Owner, may by written notice to the Company at its Home Office accompanied by this policy for endorsement, accelerate or postpone (not beyond the Annuitant's age 26) the vesting of ownership in the Annuitant. During the lifetime of the Annuitant, the Owner may, with the written consent of the irrevocably designated primary beneficiaries, if any, and subject to the provisions of the "Beneficiary" and "Assignment" sections, exercise and enjoy all benefits, rights, options, and privileges granted in or incident to this policy.

Beneficiary

The Owner, during the lifetime of the Annuitant, may from time to time change the beneficiary designation by written notice satisfactory to the Company, except that an irrevocable designation of a beneficiary may not be revoked without such beneficiary's consent. Upon receipt of such notice at the Home Office of the Company the change shall take effect as of the date on which the notice was signed, whether the Annuitant be living at the time of its receipt or not, but without prejudice to the Company on account of any payment made by it before receipt of such notice at its Home Office. The interest of the new beneficiary shall be subject to any then existing assignment of the policy. Any reference herein or in a beneficiary designation to a beneficiary living or surviving shall mean living on the earlier of (a) the day due proof of the Annuitant's death is received by the Company at its Home Office, or (b) the 10th day after the Annuitant's death. Unless the beneficiary designation shall otherwise provide, beneficiaries designated to share proceeds shall share equally, and the share of a beneficiary who does not survive shall be paid to the surviving beneficiary or beneficiaries in equal shares. If there is no surviving beneficiary and if the beneficiary designation does not otherwise provide, the proceeds shall be payable to the Owner, his executors, administrators or assigns.

Assignment

The Owner shall have the right to assign this policy and the benefits and proceeds thereof, except that an assignment shall not be binding on any irrevocably designated beneficiary without the beneficiary's written consent thereto, nor be binding on the Company unless and until filed at the Home Office of the Company. The Company assumes no responsibility as to the validity of any assignment and may rely solely on the assignee's statement as to the amount of his interest. After the release of an assignment the interest of the beneficiaries under the policy shall be the same as if the assignment had not been made.

Policy Loans

Cash Loans

While this policy is in force the Company will lend, on the sole security and upon written assignment of this policy, a sum not exceeding the loan value (as herein defined) at the end of the then current policy year. The loan value shall equal the tabular cash value plus the amount of any dividends left to accumulate at interest. In the case of Reduced Paid-up Deferred Annuity, the loan value shall equal the cash value. There shall be deducted from the proceeds of such loan any existing indebtedness, interest to the end of the current policy year, and the Company may also deduct any unpaid premium for the current policy year.

Interest and Repayment

Interest shall be at the rate of 4.8 per cent a year, payable in advance. Unpaid interest shall be added to the existing indebtedness and bear interest on the same terms. Any loan may be repaid in whole or in part during the lifetime of the Annuitant prior to maturity of the policy, except that a loan which existed at expiration of the grace period may not thereafter be repaid. Failure to repay any loan, or to pay interest, shall not avoid the policy unless the total indebtedness shall equal or exceed the loan value at the time of such failure nor until 31 days after notice shall have been mailed to the Annuitant and to any assignee of record at the Home Office of the Company, at their respective last known addresses.

Non-forfeiture Options

Options Available

Either of the following options shall be available within 60 days after the due date of any unpaid premium if the policy then has a tabular cash value:

1. Cash Value. The net cash value of the policy (defined below) as of the said due date will be paid upon surrender of the policy, or if the policy is not surrendered there shall be available a

2. Reduced Paid-up Deferred Annuity. The net cash value on the due date of the unpaid premium will be automatically accumulated at such rate of interest as the Company may from year to year declare on such funds held by it, but in no event less than 3 per cent a year. On the Maturity Date, the accumulated value will be used to purchase a monthly income payable for fifteen years of $6.75 for each $1000 of such accumulated value. Upon receipt of due proof of the death of the Annuitant while this automatic paid-up value is in effect and before the first monthly income payment is due, the accumulations to the date of death will be paid to the Beneficiary. While this automatic paid-up value is in effect and before the first monthly income payment is made, this policy may be surrendered on any policy anniversary for the amount accumulated on that date.

Values

The tabular cash values which are available at the end of each of the first fifteen policy years for which payment of premiums has been completed and at the end of each policy year thereafter if premiums for fifteen years have been completed, if this policy is without indebtedness or dividend accumulations, are shown in the accompanying table. The net cash value is equal to the tabular cash value plus the amount of any dividend accumulations and minus the amount of any indebtedness on the policy.

Table of Guaranteed Cash Values

The following table shows the guaranteed tabular cash value for an annual premium unit (exclusive of premiums for any supplemental benefits issued in connection with this policy) of $100. If such premium be greater or less than $100, the values will be proportionate. Proportionate intermediary values are allowed when premiums are paid for a fraction of a policy year. These values do not apply after income payments have commenced under any settlement or monthly income option.

Year	Cash Value	Year	Cash Value	Year	Cash Value
1	$ 62	23	$2,125	45	$4,072
2	157	24	2,189	46	4,194
3	254	25	2,255	47	4,320
4	355	26	2,322	48	4,449
5	458	27	2,392	49	4,583
6	564	28	2,464	50	4,720
7	674	29	2,538	51	4,862
8	787	30	2,614	52	5,008
9	903	31	2,692	53	5,158
10	1,023	32	2,773	54	5,313
11	1,146	33	2,856	55	5,472
12	1,273	34	2,942	56	5,636
13	1,404	35	3,030	57	5,805
14	1,539	36	3,121	58	5,980
15	1,678	37	3,215	59	6,159
16	1,728	38	3,311	60	6,344
17	1,780	39	3,410	61	6,534
18	1,833	40	3,513	62	6,730
19	1,888	41	3,618	63	6,932
20	1,945	42	3,726	64	7,140
21	2,003	43	3,838	65	7,354
22	2,063	44	3,953		

Settlement Options

Interest and Instalment Privileges

The whole or part of the net proceeds of this policy accruing either (1) as a death claim, (2) at maturity during the lifetime of the Annuitant, or (3) by election of a cash surrender, instead of being paid in one sum, may be made payable as hereinafter provided in accordance with one of the following options, or with two or more of such options in such manner as may be mutually agreed upon with the Company.

OPTION 1. *Left with the Company at Interest* (the interest to be paid annually to the payee unless otherwise agreed) for such period, with such withdrawal rights, and subject to such terms and conditions, as may be approved by the Company at the time of election of this option

OPTION 2. *Paid in Instalments of a Specified Amount each month*, or other stated interval, to continue until the proceeds, together with interest, are exhausted; provided that the total instalments payable during any 12-month period may not be less than 5 per cent of the original proceeds left under this option, and the final instalment shall be for the remainder only of said proceeds and interest. On each anniversary of the first instalment, interest will be added to the unpaid remainder of the proceeds.

OPTION 3. *Paid in Equal Instalments for a Specified Number of Years*, the amount of each instalment to be determined in accordance with the Option 3 Table below. Payments will be made annually, semi-annually, quarterly, or monthly.

The first instalment under Options 2 and 3 will be payable (1) in case of an option elected during Annuitant's lifetime for payment of a death claim, as of the date of Annuitant's death, (2) in other cases, as of the date the proceeds accrue or the date the option is elected, whichever is later.

In addition to the above options the net proceeds may be converted into a Life Income with instalments certain under the Settlement Option rates and provisions of policies being issued by the Company at the time such proceeds accrue.

Option 3 Table—Limited Instalments

Instalments for a limited number of years for each $1,000 of proceeds:

Term of Instalment Payments	Annual	Semi-Annual	Quarterly	Monthly	Term of Instalment Payments	Annual	Semi-Annual	Quarterly	Monthly	Term of Instalment Payments	Annual	Semi-Annual	Quarterly	Monthly
Years					Years					Years				
1	——	$503.39	$252.55	$84.37	6	$178.17	$ 89.69	$ 45.00	$15.03	15	$ 80.06	$ 40.30	$ 20.22	$ 6.75
2	$506.78	255.11	127.99	42.76	7	154.74	77.90	39.08	13.06	20	63.91	32.17	16.14	5.39
3	342.42	172.37	86.48	28.89	8	137.19	69.06	34.65	11.57	25	54.35	27.36	13.72	4.59
4	260.26	131.01	65.73	21.96	9	123.54	62.19	31.20	10.42	30	48.06	24.19	12.14	4.06
5	211.00	106.21	53.29	17.80	10	112.64	56.70	28.45	9.50					

Interest—Interest allowed on funds applied under Option 1 shall be at the rate of 2¼ per cent a year, and on funds applied under Option 2, 2¾ per cent a year; the sums payable under Option 3 are based on interest of 2¾ per cent a year compounded annually. A supplemental contract shall be issued for proceeds applied under any option elected and shall provide that the Company shall allow each year on funds retained such excess interest, if any, as it may from year to year declare on funds of the same classification as determined by it on the basis of the applicable option, limitations on withdrawal, and other factors.

Election of Settlement Options—Election or revocation of settlement options must be in writing filed with the Company at its Home Office, and may be in the form of a written agreement with the Company. An election may be revoked at any time before maturity of the policy. *An election shall be automatically and wholly revoked by any subsequent change of beneficiary.* If there is no election in effect at the death of the Annuitant, the beneficiary may make the election.

Settlement options are not available without the consent of the Company for a payee not a natural person taking in his or her own right, or for an assignee. In case of assignment of the policy the settlement options shall apply only to that part, if any, of the proceeds accruing to the person named in the policy as payee. The Company shall not be obligated to accept or comply with an election if the amount to be applied under any option is less than $1,000 for each payee, and if the Company shall exercise such right not to comply with an election, payment shall be made in one sum to the payee or payees entitled thereto in the absence of election of a settlement option. If the amount of any payment would be less than $10, the interval between payments may be increased at the option of the Company to a quarter-year, half-year, or year as may be required to make the payments at least $10.

Protection of Proceeds—Except so far as may be contrary to the laws of any state having jurisdiction in the premises, no part of the proceeds or interest thereon shall in any way be subject to any legal process to levy upon or attach the same for payment of any claim against any payee, and unless otherwise stated in the election and approved by the Company no payee shall have the right to withdraw any part of the proceeds or interest thereon, or to commute, change time of payment or amount of instalments, surrender for cash, borrow against or assign for any purpose whatever.

General Provisions— At the death of any payee (including the last surviving beneficiary entitled to benefits) after maturity of the policy, the Company will, in the absence of an agreement to the contrary, pay in one sum to the payee's executors or administrators: (a) any unpaid sum left with the Company under Options 1 or 2, together with any unpaid interest thereon, or (b) the commuted value (on the basis of 2¾ per cent a year compound interest) of any remaining unpaid instalments under Option 3.

DEFECTIVE ORIGINAL COPY

Premiums

emium Payments

All premiums are payable in advance either at the Home ffice of the Company in , or to a duly ithorized agent of the Company upon delivery of a receipt signed the President, Vice President, Secretary, or Treasurer of the ompany and countersigned by such agent. The insurance under is policy is based upon annual premiums payable in advance, it on any anniversary of the policy, payments may be changed an annual, semi-annual, or quarterly basis at the premium rates use by the Company at the date of issue of this policy, the basis which any payment is made being considered the basis for the ayment of subsequent premiums until a different basis is selected. ayment of a premium shall not maintain the policy in force eyond the period for which it is paid, except as herein provided. he first premium is due on the Contract Date, and each subequent premium is due at the expiration of the period for which he preceding premium was paid.

Grace

Any premium not paid on or before its due date will be in lefault, but grace of 31 days, during which the insurance will continue in force, shall be allowed for the payment of every premium after the first. If the Annuitant dies during the grace period, the unpaid premium shall be deducted from the amount otherwise payable under this policy.

Reinstatement

This policy, if it has not been surrendered for cash, may be reinstated at any time within 5 years after default in premium payment upon payment of all overdue premiums, payment or reinstatement of any indebtedness to the Company which existed at the end of the grace period, and payment of compound interest at 5 per cent a year on such premiums from their respective due dates and on such indebtedness. Indebtedness may be reinstated only to the extent it does not exceed the loan value.

Age

If the age of the Annuitant has been misstated, any sum payable or benefit accruing hereunder shall be such as the premium paid would have purchased at the correct age. The Company will admit age at any time upon satisfactory proof.

Incontestability

This policy shall be incontestable after it has been in force during the lifetime of the Annuitant for 2 years from its date, except for nonpayment of premiums. This clause shall not apply to any provisions relating to disability benefits which may be made a part of this policy.

Policy Settlement—Deferment

All sums payable by the Company under this policy shall be payable at its Home Office in   In any settlement of this policy, any indebtedness to the Company on this policy with interest shall be deducted in determining the proceeds and the Company may at its option require that the policy be delivered to it. The Company may defer the granting of a loan (except a loan solely for payment of premiums on this policy) and the payment of a cash surrender value for the period permitted by law but not to exceed 6 months after the application therefor. If payment of a cash surrender value is deferred for 30 days or more, the Company will pay interest at 3 per cent a year from the date of surrender to the date of payment.

If the monthly income payment as computed would be less than $10, the Company reserves the right to pay the net cash value of this policy in lieu of such monthly income. Income payments may be made only to a natural person taking in his or her own right. The Company will make each income payment at its Home Office by check which must be personally endorsed by the payee or other evidence of the survival of the payee must be furnished.

The Contract

This policy together with the application therefor, a copy of which is attached hereto and made a part hereof, constitutes the entire contract between the parties, and all statements made by the Annuitant shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall avoid the policy or be used in defense to a claim hereunder unless it is contained in such application. Policy years and policy anniversaries shall be computed from the Contract Date. No agent or other person except the President, Vice President, Secretary, or Assistant Secretary has authority to modify or enlarge this contract or to waive any requirement of this contract.

Change of Plan

On any anniversary while this policy is on a premium-paying basis, the Company will exchange this policy for a participating policy on the life of the Annuitant on any level premium Life or Endowment plan being issued by the Company at the time this policy was issued, for such amount as the premium under this policy would have purchased at the date this policy was issued at the Company's then published rates, provided evidence of insurability satisfactory to the Company is furnished. The exchange shall be subject to the Company's regular underwriting rules, including limits as to age and amounts of insurance, and the new policy will contain the same provisions as are contained in policies of the same type being issued by the Company on the date of this policy or at the option of the Company such provisions as are contained in policies of the same type being issued by the Company at the date of exchange. The new policy shall bear the same date as this policy and premiums under the new policy shall be deemed to have been paid to the same date as under this policy. If the net cash value of this policy exceeds the tabular cash value under the new policy, the Company will also pay the difference between such net cash value and the tabular cash value under the new policy. If the net cash value of this policy is less than the tabular cash value under the new policy, the difference between such net cash value and the tabular cash value under the new policy shall be paid to the Company.

Mr. SILVERSTEIN. Mr. Chairman, I would like to insert in the record statements by Mr. Marshall J. Mantler, on behalf of the Bureau of Salesmen's National Associations and Mr. Harold Franklin, president of the Association for Advanced Life Underwriting.

The CHAIRMAN. Without objection the statements referred to will be inserted in the record.

Thank you very much, Mr. Silverstein.

(The material referred to follows:)

STATEMENT OF MARSHALL J. MANTLER ON BEHALF OF THE BUREAU OF SALESMEN'S NATIONAL ASSOCIATIONS

My name is Marshall J. Mantler. I am managing director of the Bureau of Salesmen's National Associations, Atlanta, Ga. My appearance before this committee is for the purpose of urging the favorable consideration of H.R. 10.

The nationwide membership of the various salesmen's organizations whom I represent totals some 80,000 commission salesmen. These salesmen are perhaps the most typical example of independent self-employed persons in our modern business world.

Our organization has supported wholeheartedly the principles of H.R. 10 since its original conception 10 years ago. The need for this type of legislative concept is more apparent now than ever before. Expenses of selling have increased drastically, whereas commission returns have remained the same. The technical possibility that social security is available to salesmen is not fulfilled in any instance. In other situations, the social security amount is far less than is needed to sustain our members in their superannuated years.

The principles of H.R. 10 represent a vital plank in an overall platform of retirement planning for America's growing population. Our 80,000 members need this protection. We urge your committee to make it possible.

I thank the committee for the honor of appearing before it and will make any information in the possession of our Bureau available to the committee upon request.

Thank you.

STATEMENT OF HAROLD FRANKLIN, PRESIDENT, ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

My name is Harold Franklin. I am a practicing life insurance agent in Cleveland, Ohio. As president of the Association for Advanced Life Underwriting, I appear before this committee to urge favorable consideration of H.R. 10. The Association for Advanced Life Underwriting is a national organization whose members are leading life-insurance agents throughout the United States.

Our members, who reside in every part of this country, spend the major portion of their working days in counseling on matters of life insurance protection and problems of providing retirement income. We are continually faced with the problem of the self-employed individual who is and has been unable to provide adequate retirement income for himself and his family. These self-employed individuals are the people who typify the American free enterprise system. The great commodity which we can export to the rest of the world is the ability of any given individual in this country to attain, through his own efforts, a substantial measure of self-realization, and physical comfort and security. Not only is there no reason for discriminating in favor of corporate employees to the detriment of the enterprising individual, but such discrimination would ill-serve the broader policies and aims of this country. As a matter of fact, the interests of the independent small businessman form the fiber of the essential strength of the United States. It ill behooves the Government to persist in a tax legislative pattern which does not give him the same benefits as his corporate brother.

I would commend to this committee that it reaffirm the actions of the House of Representatives, and issue a favorable report on H.R. 10.

In the last session of Congress, H.R. 10 was reported by this committee, but was not acted upon by the full Senate. However, this committee's version of the bill in the last session would not have accomplished, in full, the purposes for which a self-employed retirement provision is intended. It would have severely

INVESTORS SYNDICATE OF AMERICA, INC.

HOME OFFICE

MINNEAPOLIS 2, MINNESOTA

INVESTMENT CERTIFICATE

WITH

OPTIONAL SETTLEMENT PRIVILEGES

IN CONSIDERATION OF THE PAYMENT TO INVESTORS SYNDICATE OF AMERICA, INC., HEREINAFTER REFERRED TO AS THE "COMPANY", AT MINNEAPOLIS, MINNESOTA, BY

OF ANNUALLY IN ADVANCE, AN APPLIED PAYMENT, FOR A PERIOD OF **TEN YEARS**, THE COMPANY AGREES, AMONG OTHER THINGS, SUBJECT TO THE PROVISIONS HEREINAFTER SET FORTH, TO PAY TO THE OWNER,

HEREIN CALLED THE "MATURITY AMOUNT", PLUS ANY OTHER AMOUNTS THEN DUE, AT THE END OF SAID PERIOD, OR AT HIS OPTION, TO PAY:

(A) SUCH AMOUNT OR AMOUNTS, OR ANY PART THEREOF, IN TERM INSTALLMENT PAYMENTS; OR

(B) INTEREST ON ALL OR PART OF SUCH AMOUNT OR AMOUNTS, IF LEFT WITH THE COMPANY FOR THAT PURPOSE, AND TO PAY THE PRINCIPAL SUM THEREOF AT OR PRIOR TO THE END OF TEN YEARS AFTER MATURITY; OR

(C) SUCH AMOUNT OR AMOUNTS, OR PART THEREOF, PLUS INTEREST ACCUMULATIONS THEREON IN A LUMP SUM, AT OR PRIOR TO THE END OF TWENTY YEARS AFTER MATURITY, IF LEFT WITH THE COMPANY TO ACCUMULATE.

THIS CERTIFICATE IS SUBJECT TO THE PRIVILEGES, TERMS AND CONDITIONS SET OUT ON THE SECOND, THIRD AND FOURTH PAGES HEREOF, ALL OF WHICH ARE HEREBY MADE A PART HEREOF AS FULLY AS IF SET FORTH ON THE FACE OF THIS CERTIFICATE.

IN WITNESS WHEREOF, THE COMPANY HAS CAUSED THIS CERTIFICATE TO BE EXECUTED IN ITS CORPORATE NAME, AT MINNEAPOLIS, MINNESOTA, THIS DAY OF 19 .

PRIVILEGES, TERMS AND CONDITIONS

ARTICLE 1. MAINTENANCE OF RESERVES. (a) The Company agrees to maintain at all times minimum certificate reserves as required under the provisions of subsection (a) of Section 28 of the Act of Congress of the United States known as the Investment Company Act of 1940, as such provisions exist at the date hereof.

(b) Reserves prior to maturity and prior to the effective date of an election to receive term installment payments under Article 5, shall consist of at least the minimum reserve payment or payments required by the provisions of subparagraph (A) of paragraph (2) of subsection (a) of said Section 28, where applicable, plus the accumulations on such reserve payments at the rate of 3½% per annum compounded annually, exclusive of any period or periods of default.

(c) From the effective date of an election to receive term installment payments under Article 5 or 6, the reserve maintained in respect hereof, shall consist of such amount, as and when accumulated at the rate of 2½% per annum, compounded annually, will provide the amount or amounts payable when due.

(d) Reserves in respect of any unapplied advance payments and additional credits shall be as provided in Articles 8 and 15 respectively.

ARTICLE 2. QUALIFIED INVESTMENTS. The Company agrees to maintain cash or qualified investments having a value not less than the aggregate amount of the certificate reserves required under the provisions of this certificate. As used herein, "qualified investments" means investments of a kind which life insurance companies are permitted to invest in or hold under the provisions of the Code of the District of Columbia, as heretofore or hereafter amended, and such other investments as the Securities and Exchange Commission of the United States shall by rule, regulation or order authorize as qualified investments. Such investments shall be valued, for all purposes under this certificate, in accordance with the provisions of said Code where such provisions are applicable. Investments to which such provisions do not apply shall be valued in accordance with such rules, regulations or orders as the Securities and Exchange Commission shall prescribe for the protection of investors.

ARTICLE 3. DEPOSIT OF ASSETS. The Company agrees to deposit and maintain cash and qualified investments with one or more independent depositaries as provided by agreements with such depositary or depositaries, or otherwise, in such manner and amount as shall be in conformity with or allowed by the provisions of subsection (c) of Section 28 of said Investment Company Act of 1940, and the rules, regulations and orders of said Securities and Exchange Commission made from time to time pursuant thereto. Any assets so deposited and any assets deposited in conformity with any statute or any rule, regulation, order or requirement of any state or of any official or agency thereof, made from time to time, shall be deemed to be maintained by the Company under the requirements of Article 2.

ARTICLE 4. MATURITY OF CERTIFICATE. This certificate shall mature at the end of ten certificate years, unless prior thereto it has been terminated, or an election to receive term installment payments under Article 5 has become effective.

ARTICLE 5. OPTION TO RECEIVE TERM INSTALLMENT PAYMENTS. The Owner may elect to receive the amount of the reserve maintained in respect hereof as provided in Article 1 (b), and any reserve maintained under Articles 8 and 15, as of the effective date of the election, or any part thereof, with future accumulations, in equal annual, semi-annual, quarterly or monthly term installment payments, as shown in Schedule B below and as hereinafter provided. Such election may be made at maturity or at any time prior thereto after the completion of the first certificate year, and shall be by written notice to the Company in the form hereinafter required. Payments may be elected for a period consisting of a number of years, not less than four nor more than thirty, except that if, at the beginning of such period, the Owner will be under age fifty, payments may be elected for a period consisting of a number of years, not less than four and not extending beyond his age eighty, but the Company shall not be required to make any installment payment of less than $10.00. Such payments shall commence at the end of the first monthly, quarterly, semi-annual or annual period, as the case may be, after the effective date of such election. Any part of such reserves not elected to be received in term installment payments shall be paid in cash at the effective date of such election, except that if such effective date is prior to maturity a charge equal to 1½% of the excess of the reserves elected to be received in cash over the amount of any reserves under Article 8 and/or 15 shall be deducted. Upon such election becoming effective, the right of the Owner to continue payments hereunder shall terminate.

RESERVE SCHEDULE A

This schedule sets forth the amount of the reserve, as maintained under Article 1 (b), at certificate year-ends attained prior to the effective date of an election to receive term installment payments, from the first to the tenth inclusive, per $1,000 of the maturity amount hereof.

Reserve at end of Certificate Year:

1	2	3	4	5
$63.44	$153.42	$246.20	$341.88	$442.00
6	**7**	**8**	**9**	**10**
$546.68	$654.64	$765.96	$880.78	$1,000.00

TERM INSTALLMENT PAYMENT SCHEDULE B

This schedule sets forth the amount of the installments of principal and accumulations thereon, on a monthly, quarterly, semi-annual or annual payment basis, payable hereunder for a period consisting of a number of years from four to thirty, inclusive, per $1,000 of the amount elected to be received in term installment payments.

No. of Yrs.	Annual	Semi-Annual	Quarterly	Monthly
4	$265.82	$132.09	$65.84	$21.90
5	215.25	106.96	53.32	17.74
6	181.55	90.21	44.97	14.96
7	157.50	78.26	39.01	12.98
8	139.47	69.30	34.55	11.49
9	125.46	62.34	31.08	10.34
10	114.26	56.78	28.30	9.41
11	105.11	52.23	26.03	8.66
12	97.49	48.44	24.15	8.03
13	91.05	45.24	22.55	7.50
14	85.54	42.51	21.19	7.05
15	80.77	40.14	20.01	6.65
16	76.60	38.06	18.97	6.31
17	72.93	36.24	18.06	6.01
18	69.67	34.62	17.26	5.74
19	66.76	33.17	16.54	5.50
20	64.15	31.88	15.89	5.29
21	61.79	30.70	15.30	5.09
22	59.65	29.64	14.77	4.91
23	57.70	28.67	14.29	4.75
24	55.91	27.78	13.85	4.61
25	54.28	26.97	13.44	4.47
26	52.77	26.22	13.07	4.35
27	51.38	25.53	12.73	4.23
28	50.09	24.89	12.41	4.13
29	48.89	24.29	12.11	4.03
30	47.78	23.74	11.83	3.94

Installment amounts set forth in the foregoing schedule are based upon an accumulation rate of 2½% per annum, compounded annually. For an installment payment period in excess of 30 years, installments will be computed on the basis used in computing the above schedule, and the Company will furnish a similar schedule of installment amounts for such period upon written request.

At any time before an election under this article to receive term installment payments has become effective, the Owner may, by written notice as herein required, change the term installment payment plan elected to any other plan which he might have originally elected, or, by written notice to the Company, cancel the election.

The notice of an election under this Article shall be in the form prescribed by the Company and shall specify the date, not later than the maturity date hereof, on which the election shall become effective, the number, kind and amount of installments elected and the period of years for which such installment payments are to be made. The period elected shall be for a definite number of years without regard to whether the installments are to be paid annually, semi-annually, quarterly or monthly. Such election shall become effective on the date specified in such notice, if this certificate is then in force.

At any time after the effective date of an election to receive term installment payments, the Owner may surrender this certificate and receive in cash an amount equal to the surrender value thereof as of the effective date of such election, or the maturity value if the election became effective at maturity, less the amount of cash received at such effective date, if any, and any term installments paid, or 98½% of the then amount of the reserve maintained in respect thereof under Article 1 (c), whichever is the larger. The Owner may at any time after the effective date of such an election, by written notice to the Company as herein required, except as to the effective date, elect to alter his existing term installment payment plan and receive the then amount of such reserve, or any part thereof, with future accumulations, in equal annual, semi-annual, quarterly or monthly installments, as specified in such notice, differing in amount, number, kind and period of years of payment from such existing plan, provided that the altered installment payment period, together with any elapsed portion of the original period, shall not be below the minimum or beyond the maximum number of years specified in the first paragraph of this Article, nor shall the Company be required to make any payment of less than $10.00. In the event of an alteration, the payments thereunder shall commence at the end of the first monthly, quarterly, semi-annual or annual payment period, as the case may be, after such election. Any part of the reserve not elected to be received in term installment payments shall be paid in cash at the time of election, less a charge of 1½% thereof if the original election to receive such payments became effective prior to maturity.

ARTICLE 6. OPTIONS TO LEAVE PROCEEDS WITH THE COMPANY AT MATURITY. Upon the maturity of this certificate unless at that time an election to receive term installment payments under Article 5 becomes effective, the Owner, by written notice, may elect to receive payment of the proceeds then available, or any part thereof, in any method described in the following options or divided between them, provided that the Company shall not be required to make an installment or interest payment of less than $10.00. At the time of such election, any proceeds not elected to be payable under Options A and/or B hereof shall be paid to the Owner in cash.

OPTION A. To receive interest at the rate of $25.00 per annum or $2.05 per month per $1,000 of the amount of proceeds available elected to be payable under this option for a period not exceeding ten years from the date of maturity, the first interest payment being due at the end of one year or one month, as the case may be, and, at the end of or at any time during such ten year period, to receive the amount of the proceeds available elected to be payable under this option, in cash upon the surrender of this certificate or he may leave all, or take any part thereof in cash and leave the balance, with the Company under and subject to Option B, any accrued interest to be then paid in cash.

OPTION B. To receive the amount of the proceeds left with the Company under this option, upon surrender of this certificate at the end of or at any time during a period of twenty years from the date of maturity, in a single payment with the accumulations thereon at the rate of 2½% per annum, compounded annually, to the date of such surrender.

The amount of the reserve to be maintained in respect to the Company's liability under this Article at any time shall be such amount as and when accumulated at 2½% per annum, compounded annually, will provide the amount or amounts payable hereunder when due.

The term "proceeds available" or "proceeds then available", as used in this Article, shall mean the entire amount which the Owner would have been entitled to receive at maturity, in cash upon the surrender of this certificate.

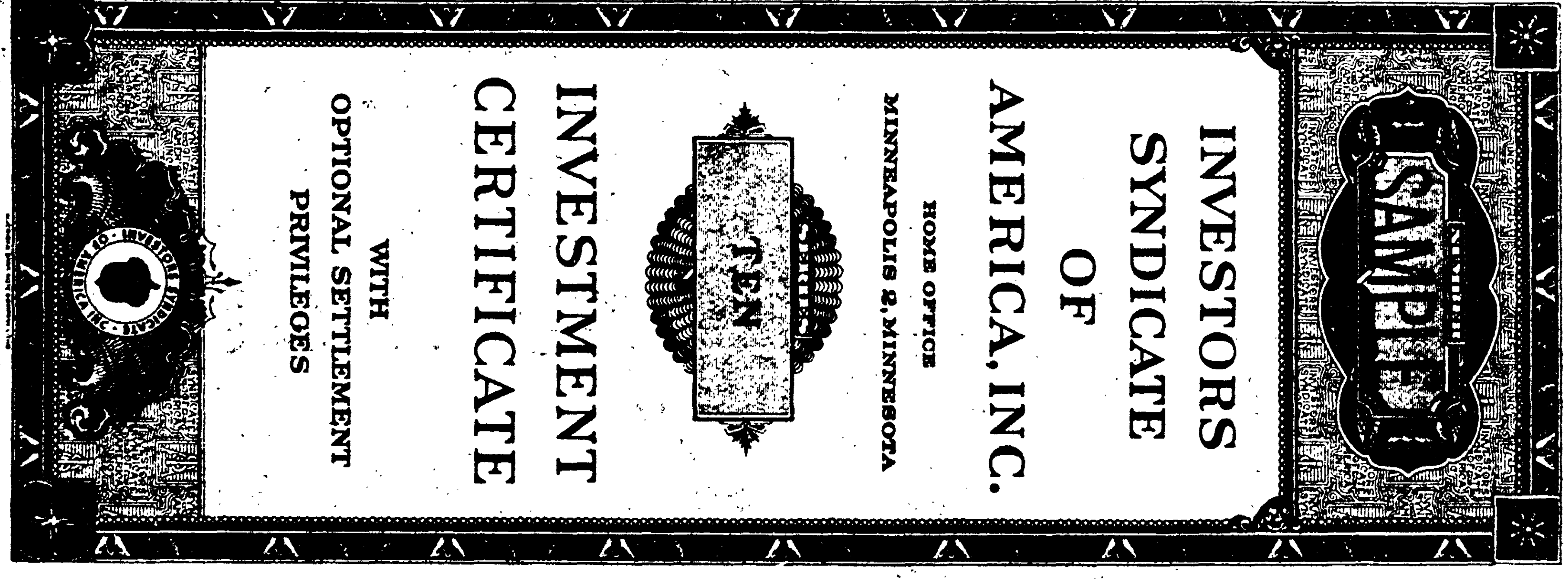
After an election under this Article to receive payment of proceeds under Option A and/or B, the Owner may at any time elect to receive payment of the reserve maintained in respect of the Company's liability under either or both of said options as of the effective date of such election, in term installment payments. Such election shall be by written notice in the form required by Article 5 except that the effective date specified therein shall be in accordance with the provisions of this Article. The effective date to so receive the proceeds left under Option A

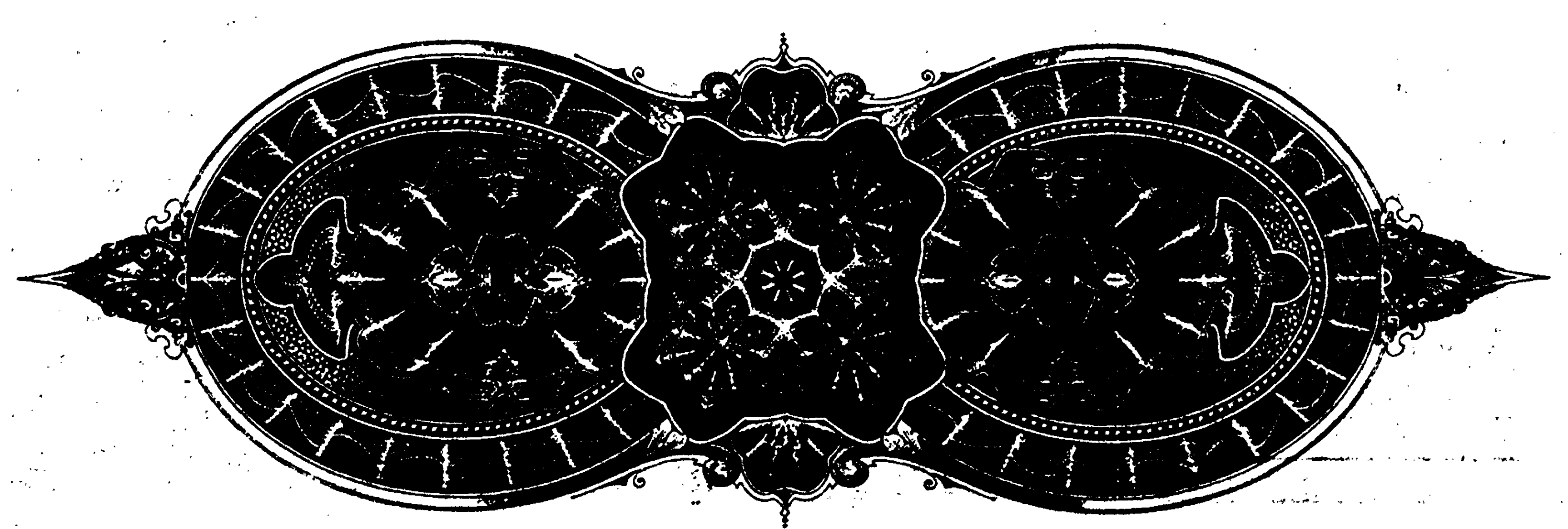
Upon a payment in full to the Owner in final settlement at maturity or under Article 5, 6, 10 or 12, or otherwise, the then amount of any existing loan indebtedness, including principal and any accrued interest, shall be deducted from the amount otherwise payable upon such settlement. Upon the exercise of any other option or right entitling the Owner to receive cash, so much of said cash shall be applied by the Company on the loan indebtedness as shall be required, if any, to reduce the same to an amount not in excess of 98⅓% of the reduced minimum reserve requirement. Upon the issuance of, or the conversion of this certificate into, a Paid Up Certificate under Article 11 or 13, such Paid Up Certificate, in lieu of this certificate, shall become the sole security for any loan indebtedness then existing.

ARTICLE 15. ADDITIONAL CREDITS. During each calendar year each certificate of this series upon which payments shall have been made so as to complete a certificate year within such calendar year, shall be credited, as of the date of such completion, with such amount as shall have been determined upon by the Board of Directors of the Company in advance of such calendar year. The amount so credited in any calendar year shall be at a uniform rate per dollar of the surrender values, as shown in Article 12 hereof, attained by such certificates at the completion of the certificate year within such calendar year. The Board of Directors shall have discretion as to whether any such credit shall be determined upon for any calendar year and as to the amount thereof, but no cash dividends shall be distributed to stockholders of the Company during any calendar year unless a credit for such year shall have been determined upon for each certificate of this series which shall become entitled thereto as hereinbefore provided, equal to at least one-half of 1% of the surrender value to be attained thereby upon the completion of the certificate year in such calendar year. No additional credits shall be payable in respect of any certificate upon the exercise of the option, provided in Article 10, to secure a refund of the entire amount paid hereon. The reserve to be maintained in respect of additional credits at any time shall be such amount or amounts as shall have been then credited to this certificate as additional credits, plus the accumulations on such respective amounts as have been standing to the credit of this certificate for not less than a certificate year, from the date of credit to such time, at the rate of 2½% per annum compounded annually, exclusive of any period or periods of default. Upon the surrender of this certificate as provided in Article 12, or upon an election to receive a Paid Up Certificate as provided in Article 13 or upon the cancellation of this certificate as provided in Article 11, the then amount of said reserve shall be paid to the Owner in cash. At maturity, said reserve shall be paid to the Owner in cash unless elected to be received in term installment payments under Article 5 or elected to be otherwise payable under Article 6.

ARTICLE 16. TRANSFER. Transfer of this certificate may be made upon request, provided it is then in force and uncancelled on the books of the Company and the transfer and the request therefor be in writing upon a form furnished by the Company, executed as it shall require. No transfer shall be valid, binding or deemed in force as to the Company until the Company's written consent shall be endorsed on or attached to this certificate and a transfer fee of $1.00 paid.

ARTICLE 17. MISCELLANEOUS. No agent or other person has authority to alter or change the terms of this certificate or to bind the Company by any statement, oral or written, not herein contained. The Company at its option may defer any payments to which the Owner may be entitled hereunder for a period of not more than thirty days, but this optional right shall not apply to any maturity payment nor to any settlement first elected under Option A or B of Article 6, provided that in the event of such deferment, the Company shall pay interest on the amount deferred for the period thereof at the rate of 3½% per annum, and provided further, that any payment shall be subject to deferment as may be provided by rules, regulations or orders made by the Securities and Exchange Commission of the United States, upon the terms and conditions prescribed in respect thereto. Under all provisions of this certificate time shall be of the essence. The term "certificate year," as used herein, means a period or periods for which one year's payment or payments have been made hereon by the Owner as provided herein, and this certificate maintained in force by such payment or payments for the time for which the same have been made. Any amount to be paid by the Company to the Owner hereunder shall be payable, and any certificate issued or written declaration made by the Company pursuant to the provisions hereof shall be deliverable at the Home Office of said Company at Minneapolis, Minnesota, unless otherwise provided herein or otherwise elected by the Company. Nothing contained in this certificate shall prevent the issuance by the Company of other securities or certificates of another series with such terms and conditions as it shall determine.





shall not be later than ten years after maturity and the effective date to so receive the proceeds left under Option B shall not be later than twenty years after maturity. In the event of such election, the provisions of said Article 5 in relation to the number, kind, amount and period of term installment payments, to the right of the Owner to change his term payment plan or to cancel his election prior to the effective date, and in relation to the rights of the Owner subsequent to the effective date of an election under Article 5, shall apply, but the amount available therefor shall be the reserve referred to in this paragraph.

ARTICLE 7. INSTALLMENT PAYMENTS. The following table sets forth a schedule of payment-periods of from one to twelve months duration, inclusive, and under each period designated, the amount which the Owner is required to pay therefor, per $1,000 of the maturity amount of this certificate.

PAYMENT-PERIOD TABLE

PAYMENT-PERIOD..........................	1 Mo.	2 Mos.	3 Mos.
AMOUNT REQUIRED TO PAY THEREFOR..	$7.78	$15.48	$23.10
PAYMENT-PERIOD..........................	4 Mos.	5 Mos.	6 Mos.
AMOUNT REQUIRED TO PAY THEREFOR..	$30.58	$37.94	$45.34
PAYMENT-PERIOD..........................	7 Mos.	8 Mos.	9 Mos.
AMOUNT REQUIRED TO PAY THEREFOR..	$52.64	$59.94	$67.22
PAYMENT-PERIOD..........................	10 Mos.	11 Mos.	12 Mos.
AMOUNT REQUIRED TO PAY THEREFOR..	$74.48	$81.68	$88.92

In meeting the requirements of any current certificate year, the Owner may pay in advance, as an annual payment, the amount specified in the above table for a twelve months' period, per each $1,000 of the maturity amount hereof, or he may pay from time to time for any period shown in said table which is unpaid for in such year, by paying, in advance, the amount specified therein for such period, per each $1,000 of the maturity amount hereof. If any payment is not in the amount required for any period shown in said table, it shall be applied in payment of the longest period within such year, not paid for, which it will pay in full thereunder. The balance thereof or any payment made, if insufficient to pay in full for a period of at least one month under the above table, shall be forthwith refunded to the Owner.

ARTICLE 8. UNAPPLIED ADVANCE PAYMENTS. The excess of any payment made during a certificate year over the requirements of such year, if sufficient to pay for a period of at least one month as shown in the table in Article 7, and any payment made during said year after the requirements thereof have been met, unless and until applied or refunded as hereinafter provided in this Article, or elected to be received in term installment payments under Article 5 shall be deemed an "unapplied advance payment." At the beginning of the next certificate year, the then amount of any unapplied advance payment or payments, with interest as herein provided, if any, together with any payment then made, or so much thereof as is necessary therefor, shall be applied as a payment to meet the requirements of such year, as provided in Article 7, and any balance remaining after such application if insufficient to pay in full at least one month shall be forthwith refunded to the Owner. Any part of an unapplied advance payment not so applied, refunded or used within thirty days after the date of payment shall bear interest at the rate of 2% per annum, compounded annually, from the date of payment to the date of application, refundment or use. The unapplied advance payment reserve to be maintained at any time shall be the amount of the present value of the unapplied advance payment or payments, computed at the rate of 2% per annum, compounded annually. Upon a surrender of this certificate as provided in Article 12, or upon an election to receive a Paid Up Certificate as provided in Article 13, or upon the cancellation of this certificate as provided in Article 11, the then amount of said reserve shall be paid to the Owner in cash. At maturity said reserve shall be paid to the Owner in cash unless elected to be received in term installment payments under Article 5 or elected to be otherwise payable under Article 6.

ARTICLE 9. PAYMENTS LIMITED. Payments to be made hereon by the Owner are payable only in installments and he shall not be permitted to make in any year, or in any period of twelve months, a payment or payments aggregating more than 20% of the maturity amount hereof, nor shall the Owner be permitted to make any payments prior to maturity aggregating in amount more than 120 monthly payments hereon.

ARTICLE 10. OPTIONAL SETTLEMENT IN THE EVENT OF PERMANENT TOTAL DISABILITY OR DEATH. Permanent total disability or death of the Owner shall not terminate this certificate, but in such an event and the furnishing to the Company within six months from the date of the discovery of such disability by the Owner or from the date of death, of such legal proof thereof as it shall require, then the Owner or his legal representatives, as the case may be, may terminate this certificate by written notice to the Company and surrender hereof and thereupon receive a refund of the entire amount paid hereon, or the amount which the Owner would then be entitled to receive in cash upon the surrender of this certificate, whichever is the greater, provided permanent total disability or death occurs prior to maturity, while the Owner is not in continuous default more than six months and before he attains age sixty or exercises an option under Article 13 and before the effective date of an election under Article 5. Permanent total disability, as herein used, shall mean a disability resulting from bodily injury or disease occurring and originating after the issuance of this certificate, which shall wholly and continuously prevent the Owner from engaging in any business or occupation or performing any work for compensation or profit for the balance of his life.

The option of the foregoing paragraph shall be subject to the following:

(a) If this certificate is made out in the name of one person in trust for another, then the option may be exercised only upon the death or disability of the former, (b) if made out in the names of joint-tenants, then the option may be exercised only in case of death or disability of the one joint-tenant who has been specifically designated either in the application or upon the assignment of this certificate as the one upon whose death or disability the option may be exercised, (c) unless made out in the name of an individual person or as stated in (a) or (b) herein, the death or disability option shall not apply, (d) the option shall be deemed waived if any payment be made to the Company on this certificate after such death or disability with knowledge thereof, (e) in case of a transfer, this option shall apply only if death or disability shall result from bodily injury or disease, occurring and originating as to the new owner wholly after the transfer of this certificate is consented to by the Company in the manner provided in Article 16.

ARTICLE 11. RIGHTS IN EVENT OF DEFAULT. The Owner shall not be liable to any legal action or proceeding for any unpaid amount on this certificate, but the failure to make any such payment at the time specified therefor shall constitute a default. If the Owner shall be in continuous default for a period of six months without having exercised the option to receive a Paid Up Certificate as provided in Article 13, the Company shall then pay the Owner the surrender value provided in Article 12 in cash if less than $100, or, if such value is $100 or more, shall issue to him a Paid Up Certificate, with terms and provisions as required by Article 13. Such payment, or the issuance of a Paid Up Certificate, or the conversion of this certificate into a Paid Up Certificate as hereinafter provided, plus payment of any amount to which said Owner shall then be entitled under Articles 8 and 15, shall operate to cancel this certificate. In lieu of issuing a Paid Up Certificate, this certificate may be converted, at the option of the Company, into a Paid Up Certificate by appropriate endorsement or declaration. If this certificate shall not be available for endorsement, the Company shall deliver to the Owner or mail to him at the last address then shown by its records, a written declaration of conversion, and thereupon this certificate shall be thereby converted into a Paid Up Certificate, and the rights and obligations of the Owner and of the Company shall be the same as if a Paid Up Certificate, with terms and provisions as required by Article 13 hereof, had been issued to him.

After six months of continuous default, if this certificate shall not then have attained a cash surrender value as provided in Article 12, the Owner shall have only the right, upon written request, the surrender of this certificate, the payment of a service charge of $1.00 and the resumption of payments, to receive a new certificate of the installment type of a kind then being issued by the Company with a maturity amount and requiring annual payments thereon not less than those provided for herein, with credit for all payments made hereon, such credit together with the payment then made by the Owner to be applied as if such credit and payment were a payment then made by the Owner on such new certificate, provided that the Company, at its option, in lieu of issuing a new certificate may elect not to cancel this certificate but to endorse and return the same as reinstated, with credit for payments made hereon, but no such credits shall be deemed an unapplied advance payment.

A default which has not continued for a period of six months may be terminated by the resumption of payments, and such resumption shall be deemed a reinstatement of this certificate. During any period that this certificate is in default, nothing shall accrue to the Owner and neither the value of this certificate nor the reserves required for it shall increase, and upon any such reinstatement of the certificate the due date of each unpaid installment and the maturity date of the certificate shall be deferred for a period of time equal to such period of default; provided, however, the Owner, at his option, may reinstate by paying the installment payment, under the Payment-Period Schedule in Article 7, sufficient to cover the payment period or periods for which a payment or payments could have been made during said default period terminated by such reinstatement, together with interest upon such payment at a rate then to be determined by the Company, but not in excess of 5% per annum, for the period of default terminated by such payment, with the same effect as if such default had not occurred.

ARTICLE 12. CASH SURRENDER OPTION. The Owner may at any time prior to maturity and to the effective date of an election to receive term installment payments under Article 5 and to the issuance of a Paid Up Certificate or the conversion of this certificate thereto under Article 11 or 13, surrender this certificate to the Company at its Home Office and receive the then amount of the cash surrender value hereof. Such value during the first certificate year shall be equal to the then amount of reserve payment or payments required in respect hereof as provided in Article 1 (b) of this Certificate, and thereafter to the then amount of the reserve maintained in respect hereof as provided in Article 1 (b), less a surrender charge of not more than 2% of the maturity amount hereof nor more than 15% of such reserve, whichever is the lesser.

The surrender value per $1,000 of the maturity amount hereof for the end of each certificate year shall be as follows:

1st	2nd	3rd	4th	5th
$62.00	$140.00	$228.00	$324.00	$424.00
6th	7th	8th	9th	10th
$534.00	$654.00	$748.00	$862.00	$1,000.00

The surrender value between certificate year-ends shall increase in proportion to the increase in the amount of reserve, as provided herein.

ARTICLE 13. PAID UP CERTIFICATE. At any time before maturity and after this certificate shall have attained a surrender value under the provisions of Article 12, the Owner may discontinue payments hereon and elect to convert this certificate into a Paid Up Certificate. Such election shall be made by written notice to the Company, and the conversion hereof into a Paid Up Certificate shall be evidenced by an appropriate endorsement or declaration made by the Company.

The Paid Up Certificate shall have the same maturity date that this original certificate would have had if continued and all subsequent payments thereon were made by the Owner at the time specified therefor. The obligation of the Company under the Paid Up Certificate shall be to pay to the Owner at maturity upon the surrender thereof an amount equal to the surrender value attained by this original certificate under the provisions of Article 12 at the date of such conversion, plus accumulations thereon at the rate of 3½% per annum, compounded annually, to the date of maturity. The obligation of the Company thereunder shall also be to issue to the Owner thereof, at his option, subject to the limitations and provisions in the following paragraph a new installment certificate. The reserve to be maintained in respect of such Paid Up Certificate shall be at any time such amount as and when accumulated at the rate of 3½% per annum, compounded annually, will provide the amount to become due at the maturity thereof. The Owner may elect at any time prior to maturity to surrender such Paid Up Certificate and to receive in cash the then amount of said reserve.

If the Company is then issuing such certificate, the holder of the Paid Up Certificate may elect to receive in lieu thereof a new installment certificate with the same terms, provisions and maturity amount as this certificate. Such option may be exercised at any time within six months from the date of the endorsement or declaration and prior to the maturity of the Paid Up Certificate. Such new certificate shall have the same reserves, surrender value and status in all respects, as this certificate would have had if it had not become a Paid Up Certificate but had been in default for and during the period that said Paid Up Certificate was in force, except that any reserves under Article 8 and/or Article 15 paid at the time of conversion of this certificate into a Paid Up Certificate shall not be reestablished. There shall be credited and applied as a payment on such new certificate as of the date of the issuance thereof, subject to the provisions of Article 7, in the same manner and with the same effect as if it were a payment by the Owner on said date, an amount equal to the excess of the then reserve of said Paid Up Certificate over the surrender value that had been attained by this certificate under Article 12, at the date of its conversion to a Paid Up Certificate. Such optional right to receive a new installment certificate shall be exercised by written notice to the Company, the payment of a fee of $1.00 and the making of a payment as provided in Article 7 hereof. Upon the issuing of such new certificate the Company shall not be liable for any refund under Article 10 hereof on account of the death or disability of the Owner occurring or originating during the period such Paid Up Certificate was in effect.

ARTICLE 14. LOAN PRIVILEGE. The Company will loan to the Owner at any time upon the execution and delivery to it of a note or loan agreement in form satisfactory to it and on assignment and delivery of this certificate or of any Paid Up Certificate resulting herefrom, as sole security therefor, any amount not greater than the amount which he would then be entitled to receive in cash upon surrender of this certificate as provided in Article 5 or 12, or upon the surrender of the Paid Up Certificate, as the case may be, the said loan to bear interest at the rate to be then fixed by the Company, but not in excess of 5% per annum, payable semi-annually in advance. The Owner may pay the loan indebtedness at any time, or he may let the principal thereof run until a final settlement, subject to the following provisions of this Article.

Whenever, at or after the maturity of a loan, the total indebtedness secured by this certificate equals the then cash surrender value hereof under Article 5 or 12, or the amount of the reserve on the Paid Up Certificate, as the case may be, the Company may apply such cash surrender value or such reserve in payment of the loan indebtedness, and thereupon this certificate, or the Paid Up Certificate shall terminate and be cancelled. If any term installment payment becomes due and payable to the Owner during the existence of a loan, such payment shall be applied by the Company, first, to the payment of interest then due and the balance thereof upon the principal of the loan indebtedness, until the loan indebtedness is fully paid or this certificate is terminated as above provided.

(Continued Following Page)

penalized stockholder-employees of small corporations and would have withdrawn from them adequate retirement benefits. I urge the committee to reconsider the actions it took in the last session of Congress and to pass H.R. 10 substantially in the form in which the bill was approved by the House.

I appreciate the privilege of being permitted to appear before this committee and put at the committee's disposal the services and facilities of the Association for Advanced Life Underwriting.

Thank you.

(By direction of the chairman, the following is made a part of the record:)

[The information contained in this letter was requested on p. 167]

WASHINGTON, D.C. *August 8, 1961.*

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: On July 28, 1961, Mr. Gerhard A. Munch, assistant general counsel of the Mutual Life Insurance Co. of New York, representing the American Life Convention, Life Insurance Association of America, Life Insurers Conference and the National Association of Life Underwriters, appeared before your committee durng its consideration of H.R. 10, a bill encouraging the self-employed to establish retirement plans.

During the course of Mr. Munch's testimony he recommended certain amendments which would be necessary in order for life insurance, endowment, and annuity contracts to compete as funding media under the provisions of the bill. At the conclusion of his testimony, Mr. Munch was asked if he would submit to the committee language which, in our estimate, would effect the necessary changes.

We are happy to submit our suggestions for possible amendments to the bill and we are attaching them to this letter.

Yours very truly,

AMERICAN LIFE CONVENTION,
GLENDON E. JOHNSON,
Associate General Counsel.
LIFE INSURANCE ASSOCIATION OF AMERICA,
EUGENE M. THORÉ,
Vice President and General Counsel.

AMENDMENTS TO H.R. 10, THE SELF-EMPLOYED INDIVIDUALS TAX RETIREMENT ACT OF 1961, IMPLEMENTING THE RECOMMENDATIONS MADE JULY 28, 1961, BEFORE THE SENATE FINANCE COMMITTEE ON BEHALF OF THE AMERICAN LIFE CONVENTION, LIFE INSURANCE ASSOCIATION OF AMERICA, LIFE INSURERS CONFERENCE AND THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Item 1. Excess contributions on behalf of owner-employees

Amend the last sentence of proposed section 401(e) to read as follows:

"For purposes of this subsection *and subsection (d)(6)*, the amount of any contribution *which is applied to the payment of premiums or other considerations under a life insurance, endowment, or annuity contract, or* which is allocable (in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance, shall not be taken into account."

Item 2. Bank trustees

Amend the second sentence of proposed section 401(d)(1) as follows:

"This paragraph shall not apply to a trust created or organized outside the United States before the date of the enactment of this subsection if, under section 402(c), it is treated as exempt from taxation under section 501(a) on the day before such date; *or to a trust which uses policies, contracts and services of a life insurance company exclusively to fund the benefits prescribed by the trust.*"

Item 3. Final distributions to beneficiaries under pension plans

Amend proposed section 401(a)(8)(B) as follows:

"(8) A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the entire interest of each employee—

* * * * * * *

"(B) will be distributed, commencing not later than such taxable year, (i) in accordance with regulations prescribed by the Secretary or his delegate, over the life of such employee (or over the lives of such employee and his spouse *or a dependent (as defined in section 152)*), *or over a period certain not to exceed 15 years, whichever is longer*, or (ii) in accordance with such regulations, over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and his spouse.

Item 4. Coverage requirements

Amend the first sentence of proposed section 401(a)(10) as follows:

"(10) If—

"(A)(i) one day in each quarter in the taxable year of the plan, an employer has more than 3 employees, or

"(ii) this paragraph applied at any prior time in respect of such plan, and

"(B) the plan provides for current or future contributions for any owner-employee,

then the trust shall be a qualified trust under this section only if each employee aged 30 years or more having a period of employment of 3 years or more is included under the plan.

Item 5. Distribution of death proceeds

Amend proposed section 401(d)(7) by striking the period at the end thereof and substituting a semicolon, and adding the following language: "*Provided, however*, That distribution may be continued in accordance with subsection (a)(8)(B)(i) to a beneficiary who is the spouse or a dependent (as defined in section 152) of the employee for the remainder of the period certain specified."

NORTHEASTERN KENTUCKY DENTAL SOCIETY,
Covington, Ky., August 1, 1961.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: The Northeastern Kentucky Dental Society requests your support of the Keogh bill (H.R. 10).

We feel that passage of this bill would not only remove the discrimination against the self-employed individual, but that it would curb inflation and encourage savings.

Thank you.

Very truly yours,

EARL E. SCHUH, D.M.D.,
Secretary Northeastern Kentucky Dental Society.

P.S. Please include this correspondence in the record of the hearings.

THIRD DISTRICT DENTAL SOCIETY,
Albany, N.Y. July 28, 1961.

Senator HARRY F. BYRD,
Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Representing the Third District Dental Society of the State of New York, I wish to convey to you our desire to be included in the record of your hearings as favoring the passage of the Keogh bill (H.R. 10). This bill is of utmost importance to us as self-employed individuals by permitting us to defer taxes on money set aside for retirement purposes.

Your assistance and support in this matter will be greatly appreciated.

Respectfully yours,

ROBERT J. DISNEY, D.D.S.,
Legislative Counsel.

THE AMERICAN BANKERS ASSOCIATION,
New York, N.Y., July 28, 1961.

Re Self-Employed Individuals Tax Retirement Act of 1961.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: This letter is addressed to you by the Committee on Employees Trusts, Trust Division, the American Bankers Association. It is written in behalf of the banks and trust companies of the country which will be charged with fiduciary duties in the management of funds that may be established under the Self-Employed Individuals Tax Retirement Act. In our appearance before your committee on June 18, 1959, and in our written statements relative to similar previous acts under consideration, we indicated our concern that the technical provisions of the legislation will enable the funds to be managed to the greatest advantage of those citizens that they are intended to help. This letter is written in the same spirit.

S. 59

The Senate currently has pending before it a bill introduced on January 4, 1961, by Senator Smathers, referred to as S. 59. This bill follows very closely bills passed by the House of Representatives in the two previous sessions of Congress (then referred to as H.R. 10), but is modified to take account of certain matters presented in the hearings before your committee in 1959 and 1960.

In our opinion, the simplicity in approach of S. 59 commends it to the further consideration of all concerned with this legislation.

H.R. 10

Concerning H.R. 10 now before you, these two technical subjects are presented for your consideration:

(1) *Proposed section 401(a)(8).*—This paragraph is one of several provisions which would affect all pension and profit-sharing trusts, not merely those in which owner-employees are involved.

If the proposed section 401(a)(8) were to be enacted as presently written, almost all existing pension and profit-sharing trusts would be disqualified, unless a reasonable period of time were given within which such trusts could be amended and action were then taken to so amend them.

In passing, it should be noted that the restrictions of proposed section 401(a)(8), which applies to the general run of employees covered by all qualified pension and profit-sharing trusts, are even more stringent than the restrictions of proposed section 401(d)(7), which applies only to owner-employees.

The proposed section 401(a)(8) requires that distributions be made in the case of an owner-employee by the taxable year in which he attains age 70½ and, in the case of another employee, by the taxable year in which he attains the age of 70½ or retirement age, whichever is later. It would further require that if distributions are to be made over a period of time, payments must commence no later than such taxable year, but may continue only over the life of the employee and his spouse or over a period not extending beyond their life expectancies.

Presumably, this in intended to limit not who shall receive the distributions but, rather, the time within which distributions must be made so as to prevent unreasonably long deferral of distributions. However, the effect of the provision as written would be to restrict the right under existing law of an employee to designate the disposition of survivor benefits to best meet the needs of his dependents.

Attention is called to the fact that under many pension plans (just as is the case with the plan for Federal employees) employees themselves bear a part of the cost of their pensions by the contributions which they make from their after-tax dollars. The proposed section 401(a)(8) would serve as a limitation on their right to designate how their own accumulations shall be paid to their beneficiaries.

Attention is also drawn to the fact that many pension plans provide benefits for the minor children of deceased employees. The provisions of proposed section 401(a)(8) would act to set up arbitrary limitations upon the time within

which distributions could be made to a minor, which limitations would depend on facts completely extraneous to the minor's situation.

It is suggested that proposed section 401(a)(8) might well be completely deleted from the bill until a thorough study has been made of its ultimate effect on the many thousands of existing plans. In the alternative, it is suggested that distributions should be permited over or within (i) the respective lives or life expectancies of the employee and his spouse or any dependent designated by him as his beneficiary, or (ii) the minority of any minor beneficiary, or (iii) a period of 15 years, whichever is the longer.

Further, it would seem reasonable that the provisions in application to owner-employees and their beneficiaries in proposed section 401(d)(7) should be made comparable to those suggested immediately above.

(2) *Proposed section 503(j)(1).*—This section defines prohibited transactions as any in which a trust directly or indirectly pays to certain proscribed persons any compensation (no matter how reasonable) for personal services rendered to the trust or acquires for the trust any property from such proscribed persons or sells any property to such persons (regardless of whether the acquisition or sale is for an adequate consideration).

These appear to be arbitrary provisions which may be intended to ease or eliminate tax audits. Are we at such a point in this legislation that we must substitute the arbitrary convenience of the tax auditor for the rule of reason in the conduct of our citizens' affairs?

For example, suppose an association of lawyers sets up a restrictive retirement plan for its members. To comply with the arbitrary provisions of proposed section 503(j), must the association employ outside attorneys for required legal work or, in the alternative, must any member doing the legal work devote his services without any compensation whatsoever for his time? Actually the penalty for a prohibited transaction, which is a complete loss of tax exemption of the fund for at least 1 year, is sufficiently severe of itself.

It is suggested that the provision dealing with this same subject in S. 59 is preferable and more in keeping with the American spirit. This provision is S. 59 is found in proposed section 405(d)(3) wherein—

> "* * * the term 'prohibited transaction' means any transaction in which the trustee—
>
> "(A) * * *
>
> "(B) pays more than reasonable compensation for personal services rendered to the fund to;
>
> "(C) * * *
>
> "(D) acquires for the fund any stock, securities, or evidences of indebtedness for more than an adequate consideration in money or money's worth from, or sells any stock, securities, or evidences of indebtedness of the fund for less than an adequate consideration in money or money's worth to,
>
> any person described in section 503(c) (for this purpose treating each member of the plan as the grantor of the trust) * * *."

We will be pleased to have the opportunity to discuss these points with your technical staff if that would be feasible. As a matter of convenience, we can be reached through Mr. Charles R. McNeill, assistant general counsel, the American Bankers Association, 730 15th Street NW., Washington 5, D.C., telephone Executive 3-1889.

Very truly yours,

CECIL P. BRONSTON,
Chairman, Committee on Employees Trusts,
Trust Division.

STATEMENT OF ARTHUR J. PACKARD, MOUNT VERNON, OHIO

Mr. Chairman and gentlemen, I am Arthur J. Packard, of Mount Vernon, Ohio. I own and operate seven small hotels in that State. I appear before you as chairman of the Governmental Affairs Committee of the American Hotel Association. Our membership comprises the great majority of the representative hotels and larger motels throughout the country with approximately 612,000 rooms in nearly 6,000 operating units.

We are concerned with H.R. 10, the Keogh bill, which is currently pending before your committee. We think it is significant that, for the second time, the House approved this legislation in this first session of the 87th Congress. With-

out doubt, the opponents of this measure feel that it would involve lost revenue. To some extent this may be so. At the same time, we think the Congress has an obligation to remove a long-time inequity in the revenue code. It seems that most tax legislation and administrative actions involves tightening of the regulations, and increasing the tax liability of our citizens, but that inequites in the code are seldom corrected if they involve any benefit to the taxpayer. We are very sure that this is an unwitting development. But it should be given full weight by your committee as you ponder the inequities of this situation.

As long as corporate employees and employers have been able to set up retirement programs, tax free, it seems most unfair that the same privilege has not been accorded proprietors and partners, or the so-called self-employed. We are not in position to deny or confirm the estimates of revenue loss issued by Secretary of the Treasury Dillon and other spokesmen for the administration, who seemed somewhat critical of H.R. 10. It is natural, however, that they would oppose the idea of surrendering any current tax revenue, and it is possible that such viewpoint shaped their thinking.

May I respectfully observe that the hotel business, frequently labeled the seventh largest industry in the country, is today the victim of many situations where we believe that we are being squeezed, or discriminated against, by the revenue code. Let me cite a few instances where we are the victims of what appears to be some form of discrimination.

1. First, we have long contended that we are subject to more excise taxes than any other industry in the country. Most of these levies, enacted during wartime, are still with us.

2. Also, we have repeatedly sought to have the tax-writing committees of the Congress hold hearings during which testimony can be presented on the practice by which tax-exempt establishments are openly competing with us for public business. Seven or eight years ago, the then Secretary of Commerce, George Humphrey, estimated before the House Ways and Means Committee that upward of 10 percent of all retail and service business was being done by tax-exempt groups. I can tell you that the percentage has certainly grown in the field of catering to nonmember groups, in housing and in the service of food and beverage. Meanwhile, our own business has dropped to a point where the loss of a number of such functions, which have always been served by our hotels and restaurants in the past, can easily mean the difference between red and black ink at the end of the year. In spite of this, there has been no opportunity to present information on this subject since 1954, and the Internal Revenue Service has apparently been unable to enforce the statutes, even though we give them specific evidence of instances where the law and the regulations are being violated.

3. Also, the President's tax recommendations, now pending before the Ways and Means Committee, include the establishment of a tax credit incentive program. This plan under proposed revisions would offer most industries up to an 8-percent tax credit on equipment and furnishings purchased, with a useful life of 6 years or longer. However, the President's recommendation specifically excludes hotels from such benefits. It is argued that any business whose major income stems from dividends, interest, royalties, or rents should not have those tax benefits which are accorded other segments of business. But hotels are not in the rent collecting business as is real estate, but are a vigorous service industry and certainly should not be classed with those more fortunate who simply collect rents, clip coupons or cash royalty checks.

As a matter of fact, our industry is in grave peril today. Our occupancy has been straight down year after year ever since 1946, with no single interruption to that trend. And according to the accounting firms which service our industry, our 1960 earnings were below those of any preceding year, going back to 1941. You probably wouldn't believe it, but we have figures to show that the Federal tax alone, paid by a sample hotel in a large city, totals more than $2 a day per room, whether that room is occupied or not. In many instances this Federal tax exceeds our payroll costs, which run as high as a booming 42 percent of income.

Our industry calculations show that 70 percent of our hotels have 100 rooms or less, so that by and large, we represent small hotels and motels, the great bulk of which are operated by proprietors or partners. (The 1958 Census of Business shows that, out of a total of 29,203 hotels in the country, 28,243 were unincorporated.) So, this legislation would be much more helpful to our people than it would be to many industries which consist primarily of large business establishments, operated by corporate groups.

The 1954 Hotel Census, the last for which all figures are available, showed that three-fourths of all hotels in the country were less than 100 rooms, so that official data would appear to confirm our estimate of 70 percent. We are not regarded as essential, by various Federal departments, until a national emergency strikes. Then, overnight, the military descends upon our hotels, using them to capacity, or taking them over for housing and feeding of military and civilian personnel. During the last war there were hundreds of hotels which did full-time war duty. But when the emergency was over, and the military withdrew, we had to go into court and sue for sufficient allowance to rehabilitate the properties. So we do have problems, gentlemen, of which the general public is not aware. This is the reason why we vigorously support the Keogh bill, since, under present operating conditions, few if any of our small operators have any reserve funds left, after taxes, with which to build up a retirement program for themselves and their employees.

We respectfully urge your committee to give careful study to the proposal that $2,500 per year, or 10 percent of income, whichever is the lesser, may be set up as a retirement fund, tax free, by self-employed persons who provide similar protection for their employees.

The CHAIRMAN. The committee will adjourn.

(Whereupon, at 1:30 p.m., the committee adjourned, subject to the call of the Chair.)

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Union Calendar No. 139

87th Congress, 1st Session } HOUSE OF REPRESENTATIVES { Report No. 378

1464-6

SELF-EMPLOYED INDIVIDUALS TAX RETIREMENT ACT OF 1961

May 9, 1961.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. Keogh, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 10]

The Committee on Ways and Means, to whom was referred the bill (H.R. 10) to encourage the establishment of voluntary pension plans by self-employed individuals, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The committee amendments are technical amendments which appear in the bill, as reported, in line type and in italic type.

I. Summary of Bill

Your committee's bill is designed to encourage the establishment of voluntary retirement plans by self-employed persons by extending to such plans, and to self-employed individuals covered thereunder, many of the favorable tax benefits present law now provides in the case of qualified retirement plans established by employers for their employees. To accomplish this purpose, self-employed persons are treated for retirement plan purposes as the employers of themselves. As employers, as with other employers, they are permitted to deduct contributions (within specified limits) made to pension or profit-sharing plans for the benefit of themselves, and such other employees as may be covered under the plan. As employees, as with other employees, they are not taxed on such contributions made for their benefit, or the income thereon, until they receive the funds upon retirement or otherwise. Benefits for the self-employed individual may not, under the bill, begin before age 59½ (except in case of early disability or death) nor later than age 70½. The retirement income

credit will apply to retirement benefits distributed to self-employed individuals.

By treating self-employed individuals as employees under retirement plans there are brought into play (although with material modification) most of the statutory and administrative rules presently applicable to such plans. The bill establishes special rules to govern retirement plans which cover self-employed individuals who own more than a 10-percent interest in their business (designated in the bill as owner-employees). Self-employed individuals who do not own more than a 10-percent interest in the business are treated in general as are all other employees.

Generally, a self-employed person who owns more than a 10-percent interest in his business is allowed under this bill to contribute to a retirement plan for himself and, if he has three or fewer employees, to deduct from his gross income, up to 10 percent of his self-employment earnings or $2,500, whichever is smaller, each year. If he has more than three employees the ratio of contributions to his self-employment earnings must not exceed the ratio of contributions to wages of any of his employees; otherwise, there is no limitation. However, contributions for such employees must be nonforfeitable at the time they are made. Also, if he has more than three employees the plan may not exclude any employee (other than part-time, seasonal, and temporary employees) who has at least 3 years of service.

The retirement fund which this bill allows self-employed persons to establish must be lodged with a bank as trustee (or as custodian if contributions are invested in stock of a regulated investment company); it may be invested in annuities with an insurance company or in face amount certificates; or it may be placed in a new series of U.S. Government bonds described in the bill. These new bonds will be nontransferable, nonredeemable before retirement, and issued only in the names of individuals. They are intended to provide a convenient and simple form of investment for retirement funds.

More than 7 million self-employed persons who pay income taxes can establish retirement plans under this bill. Because self-employed persons generally have only a limited number of employees, their retirement plans will ordinarily be much smaller in scope than most of the corporate plans already in existence. These new small retirement plans would, if present law rules were not supplemented, also offer somewhat greater opportunities for abuse than do large corporate plans. For this reason, tighter rules for these retirement plans are believed to be necessary.

II. Reasons for the Bill

The primary reason for the bill is to give self-employed persons access to retirement plans on a reasonably similar basis to that accorded corporate stockholder employees. It thus corrects a discrimination in present law under which self-employed individuals and partners are prevented from participating in retirement plans established for the benefit of their employees although owner-managers of corporations may do so.

In 1959 the Treasury Department recognized that present law did not give self-employed persons tax treatment for their retirement savings comparable to that accorded to employees covered by em-

ployer-financed pension plans. In 1960 the Treasury Department submitted an approach to the retirement problem of self-employed persons which was different from earlier legislative proposals. In effect the approach submitted by the Treasury Department would have granted self-employed individuals tax treatment comparable to that received by employees now covered by qualified pension plans by permitting them to participate in pension plans in much the same manner as employees. This approach, however, would have imposed additional restrictions on the participation of self-employed persons in qualified pension plans and would have imposed similar restrictions on the participation of corporate-owner-managers in such plans. To the extent that this bill, as approved by your committee, treats self-employed individuals as employees for the purpose of permitting them to participate in qualified pension plans it adopts the proposal that had been submitted by the Treasury. In view of the revenue loss involved, the omission of other parts of the previously submitted Treasury approach, and the relationship to the general aspects of tax reform, the present Treasury Department has expressed the view that this problem should be considered as part of next year's broad-based tax reform.

The bill seeks to encourage self-employed persons to establish voluntary plans in order to make some provision for their own retirement. However, if the self-employed person has more than three employees, the bill requires provision for the retirement needs of each of them who has more than 3 years' service if the self-employed person is to make deductible contributions on his own behalf. Moreover, inasmuch as a self-employed individual always has a vested right to contributions he makes for himself, your committee believes it is only fair to require that employees be granted similar vested rights. Thus, if there are more than three employees, contributions for them must be fully vested at the time they are made.

Your committee has provided these additional requirements in the case of plans covering self-employed persons with more than three employees because such plans more closely resemble existing pension plans than do those which cover a self-employed person with three or fewer employees. In the latter case, it is not uncommon for employees to leave the employ of self-employed persons after only a short period of service. For example, in many cases receptionists, stenographers, and other employees often plan to work for only a few years, after which they may marry and leave their employment. It would be difficult both from the self-employed person's standpoint, and from the standpoint of the Internal Revenue Service to oversee the operation of countless small plans covering long-departed employees whose whereabouts may be unknown. This difficulty is only partially offset by a 3-year service requirement for coverage of employees. Thus, your committee's bill does not require a self-employed person with three or fewer employees to establish a pension plan covering them. On the other hand, the bill does not discourage or prevent such a self-employed individual from including his employees under a pension plan if he desires to do so. To the contrary, your committee believes many a self-employed person with three or fewer employees would desire to cover his employees under a pension plan if he could make deductible contributions for himself. In this respect,

your committee's bill should encourage the establishment of such plans, thus broadening the scope of employee pension plan coverage.

The bill allows contributions to retirement plans to be a deduction for income tax purposes at the time these contributions are made, but requires that retirement benefits when received be subject to taxation. The bill thus allows deferment of tax on certain forms of savings set aside for retirement, but limits the amount of these retirement savings of self-employed persons which are so treated. Since the self-employed person is viewed as both an employer and as an employee, this deferral is consistent with present law, under which employers are permitted to deduct contributions to qualified pension plans for their employees, while employees are not required to include in their incomes such contributions, or the income thereon, until they are received as benefits under the plan.

Your committee is of the opinion that extending the coverage of individuals under voluntary retirement plans is in the public interest, and that self-employed persons should have the opportunity to obtain retirement benefits on substantially the same basis as do corporate owner-managers. The bill will make self-employment somewhat more attractive than at present compared to employment with a corporation, and will thus help to keep small business strong and independent professional practice thriving.

Under the bill there are some differences between rules covering retirement plans which include self-employed individuals and rules covering employee pension plans. These rules are considered necessary because of the unique characteristic of self-employment. Generally, the special rules require that owner-employees having more than three employees give them greater vested rights than they might obtain under the pension plan of a corporation. The special rules in the case of owner-employees with three or fewer employees generally impose rigid restrictions on amounts of contributions which are made tax deductible.

III. Present Law

Present law accords favorable tax treatment to pension and profit-sharing plans established for the exclusive benefit of employees or their beneficiaries. Employees covered under qualified plans are not taxed currently on contributions made on their behalf to these plans by their employers nor on the income from amounts so contributed. Instead, the employees generally include the benefits from such plans in taxable income only in the year they are received or made available.

The deferment of tax on retirement benefits until ultimate distribution applies whether or not the employee has vested (non-forfeitable) rights in the contributions made on his behalf. Typically, under corporate plans the employee does not have immediate vested rights to all such contributions, although plans vary considerably; they range from immediate vesting to vesting after reaching a certain number of years of service or attaining a specified age, or upon actual retirement.

The income of trusts established to administer qualified pension plans is exempt from income tax. Similarly, the Life Insurance Company Income Tax Act of 1959 granted exemption, fully effective in 1961, to income on insurance reserves established in connection with qualified pension plans. In addition, under present law, em-

ployers are permitted to take tax deductions (within specified limits) for their contributions to qualified plans. The law grants this favored tax treatment only to retirement plans which do not discriminate as to coverage, contributions, or benefits in favor of employees who are stockholders, officers, or supervisors, or employees who are highly compensated.

A qualified retirement plan cannot provide a higher rate of contribution or benefit for higher paid employees than for lower paid employees, or for shareholder employees than for those who are not shareholders. However, the dollar amount of benefits or contributions for the higher paid employees may be larger than for the lower paid employees, provided that such amounts constitute a uniform percentage of the compensation of participants.

Under appropriate circumstances, the private plan may be integrated with the social security system; if thus integrated, the proportion of social security benefits not attributable to the employee's own contributions is taken into consideration in determining whether the benefits paid by the private plan meet the nondiscrimination test. Under the law and administrative rules the benefits of the higher paid employees, after being combined with a designated portion of social security benefits, must not be larger in relation to salary than the similarly combined benefits of lower paid employees.

Under existing law more than 50,000 corporate pension plans have been established. These plans cover nearly 20 million employees and have, at the present time, somewhat more than $40 billion in assets. Corporations contribute more than $4 billion per year to qualified retirement plans.

IV. Revenue Effect

The revenue loss under your committee's bill is estimated to range from $325 to $358 million in a typical full year of operation. This estimate of revenue loss assumes that not all of the self-employed persons in various groups will establish pension plans, and that only part of the maximum allowable deduction will be taken in many cases. The percentage of maximum allowable deduction assumed to be taken ranges from 15 percent for the group of self-employed individuals with incomes of less than $3,000 to 66⅔ percent for those with incomes of over $20,000. Since the provisions of the bill would be applicable to taxable years beginning after December 31, 1961, and since many taxpayers who will ultimately avail themselves of the program will not do so immediately, the revenue loss for fiscal year 1962 is estimated at $125 million.

V. Effective Date

The provisions of this bill are made applicable to taxable years beginning after December 31, 1961.

VI. General Explanation of Bill

A. SELF-EMPLOYED PERSONS AS OWNER-EMPLOYEES

The bill provides a series of special requirements for qualification of retirement plans which cover self-employed individuals (sole proprietors and partners) having more than a 10-percent interest in the business with respect to which the plan is established. Under the bill, such self-employed individuals are characterized as "owner-employees." However, in some situations, the bill imposes restrictions upon all self-employed persons regardless of their percentage of ownership. (For example, denial of capital gains treatment on lump-sum distribution and the denial of the estate and gift tax exclusions.) Partners who do not own more than 10 percent of their business also are permitted to participate in pension plans, but because they are not owner-employees plans covering them will, in general, be governed by the nondiscriminatory rules of present law, except where the bill imposes additional restrictions upon self-employed individuals generally.

B. SELF-EMPLOYED RETIREMENT PLANS

Subject to limitations, your committee's bill would allow self-employed individuals (including partners) to be covered in qualified retirement plans. This would permit self-employed individuals to secure the benefits of current tax deductions, plus a tax-free buildup of pension fund investments, by establishing a plan which meets the requirements of the Internal Revenue Code. The bill treats plans covering self-employed persons under new rules established for that purpose. If the self-employed person is an owner-employee, the requirements applicable to a plan covering him will depend upon whether he has more than three employees.

Plans covering owner-employees with more than three employees.—In the case of an owner-employee with more than three employees, the plan must provide retirement benefits for all employees (except part-time and seasonal employees) who have more than 3 year's service and contributions for such employees must be vested at the time they are made. Although the present law provides that some employees may be excluded from pension plan coverage on the basis of a "reasonable classification," your committee believes it desirable to require an owner-employee with more than three employees to cover all of his employees except seasonal, temporary, and part-time workers, and full-time employees who have less than 3 years of service. With these exceptions employees must be covered whether they are salaried employees or wage earners, and whether or not they work in different departments or enterprises. Under present law, retirement plans can exclude employees with up to 5 years of service. Moreover, under the bill, as approved by your committee, rules applicable to plans covering an owner-employee with more than three employees will continue to apply, even after the number of employees drops below four. Thus, these rules, once applicable, will be permanent.

Plans covering owner-employees with three or fewer employees.—In the case of owner-employees with three or fewer employees, the bill does not require coverage of those employees. However, those employees may, as under existing law, be covered under a qualified pension plan if the owner-employee desires to provide retirement benefits for them. If they are covered, the plan, or the portion of the plan, covering em-

ployees must not discriminate between those employees, and there must be no discrimination as between owner-employees. But as between employees, on the one hand, and owner-employees, on the other, the nondiscrimination rules will not apply.

It is not required that contributions on behalf of employees of such an owner-employee be vested when they are made, but under a new requirement of the bill, made applicable to retirement plans generally, contributions or benefits for employees must be vested upon termination of the plan or upon complete discontinuance of contributions under the plan.

C. SELF-EMPLOYMENT EARNINGS

The measuring rod for deductible contributions for self-employed persons is "self-employment earnings." Under your committee's bill, a proprietor or partner may be covered under a qualified retirement plan if he has such earnings. For purposes of this bill such earnings are defined generally to mean net earnings from self-employment as in section 1402(a); that is, the net income "derived by an individual from any trade or business carried on" by him or by the partnership of which he is a member. This definition includes persons who have net earnings from self-employment even though they do not pay a self-employment tax, for example, because they also have wages (as employees of another business) of at least $4,800. Such a person is permitted to participate in an owner-employee plan even though contributions also are being made for him under a qualified plan of his employer. Moreover, the bill also permits doctors and ministers, as well as certain persons who work in their own homes, and commission salesmen (other than full-time life insurance salesmen who are treated under present law as employees for pension purposes) to participate even though they do not have net earnings from self-employment within the meaning of the Internal Revenue Code.

D. LIMITATIONS ON DEDUCTIBLE CONTRIBUTIONS FOR SELF-EMPLOYED

The bill restricts the amount of deductible contributions which may be made by or for an owner-employee covered by a plan.

Owner-employee with more than three employees.—If the owner-employee has more than three employees, in order for him to make any contribution for his own retirement needs he must cover all his employees who have more than 3 years' service. Moreover, he must give each of them nonforfeitable rights to contributions made for them at the time such contributions are made. Having made these provisions for his employees, such an owner-employee under the bill is permitted to contribute and deduct for himself up to the same proportion of his covered income as the plan requires to be contributed for employees. Contributions for the owner-employee with more than three employees are not restricted by the 10-percent $2,500 limitation on deductible contributions for an owner-employee with more than three employees. For application of this limitation to a plan coordinated with social security, see section F.

A real estate broker with four full-time employees earns $30,000 in a certain year from commission selling. All employees have more than 3 years' service. Two of the employees earn $4,000 each; the other two earn $10,000 each. The plan calls for nonforfeitable con-

tributions for each employee who has more than 3 years' service of 20 percent of his earnings. Thus, for his employees, the owner-employee would contribute, and deduct, $5,600 (20 percent of $28,000). And, for himself, he would be permitted to contribute, and deduct, the same proportion of his self-employment earnings, $6,000 (20 percent of $30,000).

Owner-employee with three or fewer employees.—If an owner-employee has three or fewer employees, he may contribute to a qualified pension plan and deduct up to 10 percent of his self-employment earnings, or $2,500, whichever is the lesser. He may provide pension plan coverage for his employees under the nondiscriminatory rules of existing law, if he so desires. If he covers his employees in a pension plan it is not required that contributions for himself be related to contributions for his employees, but as between the employees contributions and benefits must be nondiscriminatory.

The following examples illustrate the application of the limitations of the bill on deductible contributions which may be made by a self-employed individual with three or fewer employees.

> Example 1: A lawyer has self-employment earnings of $30,000. He has no employees. He may contribute, and deduct, $2,500 (the lesser of $2,500 or 10 percent of $30,000).
>
> Example 2: A physician, whose self-employment earnings amount to $25,000, has three employees, each of whom he pays $5,000. He establishes a retirement plan covering both himself and his employees. The plan calls for contributions of 10 percent of self-employment earnings for him and 8 percent of salary for the employees. Contributions for the employees are forfeitable at the time they are made. The plan is a qualified plan under the bill and the amount deductible is $3,700 ($2,500 for himself (10 percent of $25,000) and $1,200 for his employees (3 times $5,000 times 8 percent)).

E. VESTED BENEFITS

The bill, as approved by your committee, adds new requirements to the statute relating to vesting of benefits or contributions made for employees.

Owner-employee with more than three employees.—In the case of owner-employees with more than three employees, contributions for employees with more than 3 years service under a plan must be nonforfeitable at the time they are made. This requirement is made a condition governing the qualification of a plan covering such owner-employees, and unless a provision for vesting is included in the terms of the plan contributions for owner-employees would not be deductible.

Owner-employee with three or fewer employees.—There is no corresponding requirement for vested employee benefits in the case of owner-employees with three or fewer employees. If such owner-employees choose to provide retirement plans for their employees, the plan may provide forfeitable benefits or it may provide for vesting. However, if there is a plan covering employees of such an owner-employee, the bill elsewhere provides (in connection with all retirement plans, including plans provided by corporations) that upon termination or complete discontinuance of contributions under a plan amounts credited to an employee's account must be nonfor-

feitable. This new provision adds to the statute a requirement which has been in the Treasury regulations for many years. Thus, while there is no requirement for immediate vesting, the bill precludes the possibility that contributions for employees which have been deducted for income-tax purposes may revert back to the employer, or owner-employee. This requirement should serve to prevent abuses resulting from termination of plans.

F. INTEGRATION WITH SOCIAL SECURITY

Under your committee's bill, retirement plans covering owner-employees may be integrated, or coordinated with social security under special rules provided by the bill. Under such integration or coordination, the overall cost of a retirement plan might be materially reduced. The present integration rules assume that the employer has paid for that portion of the social security benefit for which the employee himself has not paid.

Owner-employee with more than three employees.—If an owner-employee with more than three employees establishes a retirement plan which meets the prescribed requirements as to coverage and vesting, and if deductible contributions for owner-employees are not more than one-third of the total contributions made under the plan, owner-employees, if they take into account self-employment taxes paid on their own behalf, may also take into account the employer portion of the FICA tax paid on behalf of covered employees. The method of coordinating such pension plan and social security payments under your committee's bill is different from the method permitted by Treasury rulings under the provisions of present law. Under this bill the owner-employee is given credit only for the amount of social security taxes actually paid by him for his employees. The following example illustrates the application of this rule.

A and B, equal partners in a contracting business, have six employees, each of whom has more than 3 years' service. A retirement plan is established under which employees with more than 3 years' service will be given immediate nonforfeitable rights to contributions made on their behalf. The plan calls for contributions of 15 percent of gross salary for covered employees, and of 15 percent of self-employment earnings for owner-employees, with provision for coordinating the plan with social security. Salaries of employees and self-employment earnings of the partners appear in the following schedule, along with other pertinent information.

	Earnings	Total earnings or wages	15 percent of earnings or wages	Total self-employment tax (4½ percent of $4,800) and FICA tax paid by employer (3 percent of up to $4,800)	Contribution under integrated plan
2 partners	[1] $7,500	$15,000	$2,250	$432	$1,818
4 employees	[1] 6,000	24,000	3,600	576	3,024
1 employee	5,000	5,000	750	144	606
1 employee	4,000	4,000	600	120	480
Total partners		15,000	2,250	432	1,818
Total employees		33,000	4,950	840	4,110
Total partners and employees		48,000	7,200	1,272	5,928

[1] Each.

Thus, since contributions for owner-employees, after coordination with social security ($1,818), do not exceed one-third of deductible contributions under the plan ($5,928), social security and self-employment taxes may be taken into account. After coordination, $5,928 must be contributed under the plan, of which $1,818 is attributable to owner-employees and $4,110 is attributable to employees, as shown in the schedule.

Owner-employee with three or fewer employees.—Owner-employees with three or fewer employees are not required by the bill to provide retirement plan coverage for their employees unless they choose to do so. If they provide such a plan for their employees, the plan, or the portion of the plan relating to employees, may be coordinated with social security under the rules of existing law.

G. METHODS OF FUNDING

Trusteed plans and employee annuity plans.—As under present law, qualified retirement plans covering self-employed individuals or self-employed individuals and their employees may be funded either through contributions to a trust or by purchase of annuity contracts (including variable annuity contracts) directly from an insurance company. Self-employed individuals establishing such plans for themselves, or for themselves and their employees, could, if they chose to do so, use associations to pool their separate funds for investment purposes.

Custodial accounts.—In addition, your committee's bill permits the use of a custodial account, in lieu of a trust, if its investments are made solely in a regulated investment company which issues only redeemable stock. Although a custodial account may be utilized by a retirement plan, whether or not it includes an owner-employee, it will be particularly beneficial to small owner-employee-type plans because of its lesser costs. Such lesser costs result from the fact that the bank would not be required to assume the duties and responsibilities of a trustee, but would serve only as a mere custodian of amounts contributed under retirement plans.

Face amount certificates.—Your committee has also made it plain that retirement funds may be invested directly in nontransferable face-amount certificates, which would be treated for retirement plan purposes as annuities. Such certificates may presently be purchased by a trusteed plan under existing law, but not under nontrusteed annuity plans. Your committee's bill makes it clear that such certificates may in the future be purchased in the same manner as annuities.

Bond purchase plan.—A completely new form of retirement plan involving direct investment in a new series of Government bonds is authorized by your committee's bill. The principal features of the bond purchase plan are explained in section J of this report.

H. CONTRIBUTORY PLANS

Owner-employee with more than three employees.—Under the bill, contributory retirement plans permitting or requiring contributions by employees, as well as those to which the employer alone makes contributions, may be established by an owner-employee with more than three employees. If employees, who are not owner-employees are permitted to make nondeductible contributions to the plan, such an

owner-employee also may make nondeductible contributions on his own behalf up to 10 percent of his self-employment earnings or $2,500, whichever is the lesser; however, the rate of such contributions must not exceed the rate permitted for employees. Such contributions will not be deductible either by the employee or the owner-employee, but must be made out of income that has already been taxed. The making of such nondeductible contributions are beneficial, however, because the income earned thereon will not be taxed until it is received from the fund, upon retirement or otherwise.

Owner-employee with three or fewer employees.—Owner-employees with three or fewer employees are not permitted to make nondeductible contributions for themselves, although the plan might permit employees who are covered (if any) to make nondeductible contributions on their own behalf. Consequently, they may establish such a plan for their employees if they so desire.

I. PROFIT-SHARING PLANS

Your committee's bill does not limit participation of self-employed individuals to fixed contribution pension plans. Rather, it alsc permits them to participate in profit-sharing plans paying retirement benefits, under which contributions may be made in profitable years but there would be no obligation to make contributions in years of little or no profit. To avoid the abuse of making larger or smaller contributions in years when surtax rates are lower or higher, a definite formula for determining the amount of contributions to be made on behalf of employees who are not owner-employees appears to be necessary. Consequently, in order for an owner-employee to participate in such a plan, it must provide such a definite formula.

J. BOND PURCHASE PLANS

As an alternative form of investment which will be of particular interest to new pension plans established by small businesses, direct investment in U.S. Government securities of a new series is authorized. These new bonds, which must be issued in the names of the individual employees (including owner-employees) on whose behalf they are purchased (and thus will be nonforfeitable), will be nontransferable and may not be cashed until the individual in whose name the bonds are issued has attained age 59½ (insurance age 60) or has become disabled or deceased. In order to prevent these bonds from being used for purposes other than retirement, the bill provides that interest on them must stop no later than 5 years after the death of the bond owner. This period corresponds generally to other provisions of the bill requiring distribution of a deceased owner-employee's interest in a retirement plan within a specified period after his death. The purpose of direct bond purchases under a qualified retirement plan is to avoid the expense of establishing a trust to administer the retirement fund assets. The new series of Government securities may also be purchased by the trustee of an existing pension plan if it is desired to make that form of investment. Where a pension plan has invested in these retirement bonds, the bill provides that no income will be realized by the employee at the time the bonds are distributed to him; rather the principal and interest on the bonds will be included in the employee's income at the time they are re-

deemed. Although these new bonds may be purchased by anyone, their cost will be deductible for income tax purposes only if they are purchased under a qualified bond purchase plan or by a qualified retirement plan. The amount deductible is to be determined in the same manner as if the cost of the bond were a contribution to a qualified retirement trust, except that the special rules relating to excess contributions in the case of owner-employee type plans do not apply. Those rules are considered inappropriate to qualified bond purchase plans not only because the special bonds might be purchased by anyone (and not solely for retirement purposes), but also because the denominations in which the bonds might be issued will not necessatily bear any relation to the amount which might be deducted by an owner-employee. Under the bond purchase plan approved by your committee, income realized on the redemption of the special bonds will always be taxed at ordinary rates. Moreover, there would be no capital gains treatment on a lump-sum distribution of these special bonds to an individual covered by a qualified pension trust. By making the earliest redemption date for these bonds age 59½, except in the case of death or disablity, these bonds will generally be unattractive to ordinary investors because they may hesitate to freeze their capital for long periods of time.

K. EXCESS CONTRIBUTIONS

The bill provides certain penalties where excess contributions are made under a pension plan. An excess contribution is an amount greater than the permitted deductible and nondeductible contributions. The bill requires that any such excess contributions must be returned to the person or to the business that made it, together with income earned on the excess contribution. The income so returned will be taxable to the self-employed person for whom the contribution was made. If an excess contribution is not repaid within 6 months after notification has been received that the contribution was excessive, the plan is temporarily disqualified (until the excess is returned) with regard to the person on whose behalf the excess contribution was made and he is taxed on the annual income earned by the entire fund in the plan which is attributable to his interest. Where an excess contribution is willfully made, however, the entire interest of the individual on whose behalf it was made in all plans in which he participated as an owner-employee (including the corpus allocated to his account) is required to be distributed to him, and he is further disqualified from participating in any pension plans as an owner-employee for a 5-year period. Furthermore, no opportunity is given to repay a willful excess contribution and escape the consequences.

L. PAYMENT OF BENEFITS TO OWNER-EMPLOYEES

The bill requires that new retirement plans established by owner-employees for their own benefit, or for the benefit of themselves and their employees, may not begin paying retirement benefits to owner-employees before they reach age 59½ (insurance age 60) except in the event of death or disability. Under your committee's bill an individual is considered disabled if unable to engage in any substantial gainful activity because of a medically determinable physical or mental impairment which can be expected to result in death or to be of long-

continued and indefinite duration. Distributions of retirement benefits, however, must begin not later than 70½ (insurance age 70). If the owner-employee dies, his interest in the retirement plan must be distributed within 5 years from the date of his death or used within 5 years to purchase an immediate annuity for his beneficiary.

M. PREMATURE DISTRIBUTIONS

A penalty is imposed by the bill in cases where a premature distribution of all or part of the retirement fund is made before the owner-employee reaches age 59½. In these cases, if the premature distribution amounts to $2,500 or more, the tax imposed would not be less than 110 percent of the increase in tax that would have resulted if the income had been received ratably over the 5 years ending with the year of distribution. For purposes of this provision, taxable income for any of the taxable years involved is deemed to be not less than the appropriate portion of the distributed amount. If the premature distribution amounts to less than $2,500, the tax due would be 110 percent of the increase in tax resulting from inclusion of the entire amount of the premature distribution in gross income for the current year. In either event, the taxable income for the year in which the distribution occurs is treated as being not less than the excess of the amount of the distribution includible in gross income over the deductions allowable for personal exemptions. Any resulting increase in tax can be reduced only by the credit for withheld taxes. As a further penalty in case of a premature distribution, the owner-employee is disqualified from participating in a retirement plan on his own behalf for 5 years following the year in which the total distribution is made. These penalties are imposed in order to prevent retirement plans from, in effect, becoming income-averaging plans under which deductible contributions would be made to the plan in high-income, high-tax years and the assets would be drawn down in low-income or loss years when little or no tax would be due. It is the purpose of this bill to provide means for financing retirement; these penalties are designed to insure that retirement plans will not be used for other purposes.

N. TWO OR MORE BUSINESSES

An owner-employee (or a group of two or more owner-employees) who controls more than one business would be required under the bill to group together all controlled business activities for the purpose of determining whether contributions for him would be limited by the rules which apply to owner-employees with three or fewer employees or whether he would be governed by rules applicable to owner-employees with more than three employees. An owner-employee may not exceed the limitations on deductible contributions by splitting his activities among two or more businesses and establishing retirement plans in each, nor could he divide his businesses and set up a retirement plan in one business in which, for example, he is the only employee.

O. ANNUITY TREATMENT FOR DISTRIBUTIONS

As under present law, retirement benefits when paid to individuals from qualified plans would be taxable as ordinary income, except to the extent that they have been financed by nondeductible contribu-

tions made under a contributory pension plan, in which case benefits would be taxable under existing rules which allow individuals to recover their capital invested in a retirement contract free of tax.

P. ESTATE AND GIFT TAX EXEMPTION

With respect to the estate and gift tax exemption in the case of retirement plan benefits, your committee's bill does not change present law as it applies to ordinary employees, including owner-managers of corporations. However, the bill does not extend these exemptions to the self-employed (whether or not they are owner-employees) insofar as contributions were made to the plan by or for the individual while he was a self-employed person. The estate and gift tax exclusions will continue to apply with respect to any employer contributions made while the individual was not a self-employed person.

Q. LUMP-SUM DISTRIBUTIONS

While your committee's bill does not extend to self-employed individuals (whether or not they are owner-employees) capital gain treatment on certain lump-sum distributions from retirement plans, such treatment is not denied to employees of the self-employed who are treated in the same manner as employees of corporations. Under the bill, a self-employed individual will receive capital gains treatment on that portion of a lump-sum distribution which is attributable to any employer contributions made on his behalf while he was not a self-employed person. He will not have capital-gain treatment for lump-sum distributions derived from contributions as a self-employed person, but a special averaging device provides for the taxing of such lump-sum distributions received by self-employed individuals after age 59½. Under the bill, the tax he will pay is limited to five times the increase in tax resulting from treating 20 percent of such a lump-sum distribution as taxable income. In this way some protection from the graduated rates of the individual income tax is given to the self-employed individual who receives a lump-sum distribution.

R. PROHIBITED TRANSACTIONS

The bill tightens the prohibited transaction rules of present law with respect to trusts forming part of pension plans covering owner-employees who control the business by means of a more than 50-percent ownership interest. In these situations, since the owner-employee is, in effect, dealing with himself, your committee has provided that the owner-employee may not borrow from a trust he has established, may not buy from or sell property to that trust, and may not charge any fees for services he renders to the trust. It may be extremely difficult to police the large number of small trusts that may be established under this bill, and for this reason the prohibited transactions rules have been tightened.

S. SUMMATION OF REQUIREMENTS FOR OWNER-EMPLOYEE PLANS

In summary, new retirement plans established by self-employed individuals must meet the following requirements or qualifications in addition to those which present law requires of all retirement plans:

(1) If it is a trusteed plan, the trustee must be a bank or similar institution with fiduciary powers, but another person (who may be the employer) may be given power to control investments of the trust fund.

(2) In the case of owner-employees, benefits may not be payable before the owner-employee reaches age 59½, except in the case of severe disability or death, and benefit payments must begin before he reaches age 70½.

(3) In the case of plans of self-employed individuals with more than three employees, contributions for employees must be nonforfeitable at the time they are made.

(4) In the case of a profit sharing plan, a definite formula for determining employee contributions must be provided.

(5) If there are more than three employees contributions for the owner-employee are not permitted to exceed the ratio of contributions for any other employee.

(6) Where a self-employed individual has more than three employees, the plan may be coordinated with social security (under special rules) only if contributions for him are not more than one-third of the total contributions made under the plan.

(7) No excess contribution may be made.

(8) If an owner-employee dies, his entire interest must within 5 years be distributed to designated beneficiaries or used to provide immediate annuities for them.

(9) Excess contributions, if made, must be returned to the person who made them, and income earned by the plan which is attributable to the interest of an owner-employee with respect to whom an excess contribution was not timely returned must be taxed to the owner-employee.

(10) For purposes of qualifying the plan and determining what limitations are applied to contributions for owner-employees, two or more businesses controlled by an owner-employee or by a group of owner-employees must be considered as a single business.

(11) Contributions on behalf of any owner-employee must be determined on the basis of his net earnings from self-employment from the trade or business with respect to which the retirement plan is established.

VII. Provisions of Bill Made Applicable to All Retirement Plans

The bill adds three new paragraphs to section 401(a) of the code; these have the effect of codifying certain regulations and administrative practices of the Internal Revenue Service. These three new paragraphs apply to all pension plans, not merely those which cover owner-employees.

Vesting on termination of plan.—The first of these new paragraphs requires that, upon termination of the plan or complete discontinuance of contributions thereto, the rights of all employees then covered by the plan must be nonforfeitable. This new provision is especially important in connection with new retirement plans established by owner-employees with three or fewer employees. Without such a requirement, it would be possible for such an owner-employee to establish a forfeitable pension plan for his employees, make deductible

contributions, enjoy a tax-free buildup of income on such contributions and subsequently terminate the plan and have the entire amount revert back to him with favorable tax results. This requirement imposes upon owner-employees an obligation, upon termination of a plan, to actually pay out to his employees amounts contributed for them notwithstanding the fact that such contributions were forfeitable when they were made. It thus prevents abuses from developing under purely forfeitable plans.

Time of payment of benefits under a plan.—The second of these new paragraphs makes employee benefits payable not later than the taxable year in which the employee reaches age 70½, or retires, whichever is later. In the case of an employee who is an owner-employee benefits must be payable not later than the taxable year in which he reaches age 70½.

Forfeitures.—The third of these new paragraphs imposed upon all retirement plans makes it plain that forfeitures of nonvested funds must not be used to increase the benefits any employee would otherwise receive under the plan.

VIII. Miscellaneous Provisions of the Bill

The bill permits self-employed individuals to qualify for the retirement-income credit on the basis of distributions from qualified retirement plans. However, it does not permit self-employed persons to qualify either for the $5,000 death-benefit exclusion or for the sick-pay exclusion. Those provisions were enacted for the benefit of employees as contrasted to the self-employed and it is not the purpose of this bill to treat self-employed individuals as employees except for retirement-plan purposes. However, the bill does allow a self-employed individual to exclude from his gross income under section 104 of the code amounts received through accident or health insurance for personal injuries or sickness, to the extent that such amounts are attributable to his own nondeductible contributions.

Where pension contributions take the form of the purchase of annuities, any loans against these contracts are treated as distributions and any repayments of such loans are treated as contributions. In addition, if any portion of a trust or of a contract is assigned or pledged, that portion is also treated as a distribution from the trust or under the plan. Without these rules, an owner-employee could, in effect, obtain premature access to a substantial portion of the pension funds being accumulated for his retirement.

The bill makes it plain that the deduction for contributions made to a retirement plan by a self-employed individual on his own behalf may not be used to increase a net operating loss, and that owners of unincorporated businesses which elect to be taxed as corporations may participate in qualified retirement plans only in their capacity as self-employed persons. The bill also makes it clear that amounts contributed to a qualified retirement plan by a self-employed individual which are deductible, are treated as deductions from gross income in computing adjusted gross income. Thus, a self-employed individual may take this deduction and still qualify for the standard deduction.

Technical Explanation of the Bill

FIRST SECTION. SHORT TITLE

The first section of the bill provides that the act may be cited as the "Self-Employed Individuals Tax Retirement Act of 1961."

SECTION 2. QUALIFICATION OF PLANS

Section 2 of the bill amends section 401 of the Internal Revenue Code of 1954 to provide for the coverage of self-employed individuals under qualified pension and profit-sharing plans. In addition, section 2 amends section 401 to add additional requirements which must be met in order for a trust forming part of a plan covering self-employed individuals who own more than 10 percent of the business to qualify under section 401. There are also added to section 401 certain additional requirements which must be met by all qualified trusts and plans.

Section 401(a)

Existing section 401(a)(5) of the code provides that a plan shall not be considered discriminatory merely because the contributions or benefits under the plan bear a uniform relationship to the "total compensation, or the basic or regular rate of compensation," of the employees covered under the plan. Paragraph (1) of section 2 of the bill amends section 401(a)(5) to provide that, for purposes of this rule, the total compensation of a self-employed individual is such individual's self-employment earnings (as defined in sec. 401(c)(3)), and that the basic or regular rate of compensation of such an individual is that portion of his self-employment earnings which bears the same ratio to his total self-employment earnings as the basic or regular compensation of the employees (other than self-employed individuals) covered under the plan bears to their total compensation. This ratio is to be computed in accordance with regulations prescribed by the Secretary or his delegate.

Existing section 401(a) of the code sets forth the requirements which a pension, profit-sharing, or stock bonus trust must meet in order to constitute a qualified trust. Paragraph (2) of section 2 of the bill adds additional requirements (new pars. (7) to (12), inclusive).

The new paragraph (7) of section 401(a) provides that a trust will not qualify unless the plan of which it is a part provides that, upon its termination or upon complete discontinuance of contributions under the plan, the employees covered under the plan will be granted immediate vested rights with respect to so much of their benefits under the plan as have accrued and have been funded at the time of the termination or discontinuance or, in the case of a money purchase plan, will be granted immediate vested rights to the amounts credited to their account as of the date of the termination or discontinuance. This provision is not to be applicable, however, to benefits or contributions which, pursuant to regulations prescribed by the Secretary or his delegate to preclude discrimination, may not be used for designated employees in the event of early termination of the plan. For example, this provision would not require vesting when certain officers or highly compensated employees are, at the inception of the plan, within a few years of retirement age and the

granting of vested rights to such employees upon termination of the plan shortly after they reach retirement age would result in the plan being discriminatory in favor of such officers or highly compensated employees.

The new paragraph (8) of section 401(a) provides that a trust will not qualify unless, under the plan of which it is a part, the entire interest of each employee either (A) will be distributed to him before the close of his taxable year in which he attains the age of 70½ years, or, in the case of an employee other than an owner-employee (as defined in sec. 401(c)(4)), in which he retires, whichever is the later, or (B) will be distributed, commencing before the close of such taxable year (i) over the life of such employee or over the lives of such employee and his spouse, or (ii) over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and his spouse. For these purposes, the Secretary or his delegate is to issue regulations prescribing the specific conditions under which these requirements will be considered to be met.

The new paragraph (9) of section 401(a) provides that a trust forming part of a pension plan will not qualify unless the pension plan of which it is a part provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan. Therefore, if the plan calls for future contributions, the forfeitures must be used to reduce such contributions.

The new paragraphs (10) and (11) of section 401(a) provide the rules relating to the extent to which a plan covering self-employed individuals must satisfy the nondiscrimination requirements in section 401(a). Under paragraph (10), a plan providing for current or future contributions for any owner-employee (i.e., a self-employed individual owning more than 10 percent of the trade or business) must also cover each employee of such trade or business having a period of employment of 3 years or more, if—

> (1) on one day in each quarter in the taxable year of the plan, the employer has more than three employees; or
>
> (2) on one day in each quarter in a prior taxable year of the plan, the employer had more than three employees and the new paragraph (10) applied to such plan.

For purposes of determining whether the employer has more than three employees, the new paragraph (10) provides that there shall not be taken into account any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year. In addition, it is provided that there shall not be taken into account, as an employee, any owner-employee. Paragraph (10) also provides that, in determining the period of employment of a partner who is not an owner-employee, the period of time during which he has been such a partner shall be included in his period of employment.

The new paragraph (11) provides that if section 401(a)(10) does not apply and if the plan benefits owner-employees, then the determination as to whether a trust forming part of the plan is a qualified trust is to be made under section 401—

> (1) if such plan benefits only owner-employees, without regard to the fact that such plan does not benefit employees other than owner-employees; and
>
> (2) if such plan also benefits employees other than owner-employees—

(A) with respect to the portion of the plan which benefits employees other than owner-employees, without reference to the portion of the plan which benefits owner-employees; and

(B) with respect to the portion of the plan which benefits owner-employees, without reference to the portion of the plan which benefits employees other than owner-employees.

Thus, a sole proprietor, or a partnership, with three or less employees may establish a qualified plan which covers (1) only such proprietor or the partners (excluding any partner who does not own more than 10 percent of either the capital interest or the profits interest in the partnership), (2) only the employees (including any partner who does not own more than a 10-percent interest in the partnership), or (3) both such proprietor or partners and such employees. In the third case, the nondiscrimination requirements must be satisfied as to each portion of the plan.

The new paragraph (12) of section 401(a) provides that a trust forming part of a plan covering a self-employed individual owning more than 10 percent of the business must, in order to qualify under section 401, also meet the new requirements of section 401(d).

Section 401(c)

Paragraph (3) of section 2 of the bill adds a new subsection (c) to section 401(a) of the code, which contains certain definitions relating to self-employed individuals and owner-employees.

(1) *Definition of employee.*—Under the present law, a qualified plan can cover only those individuals who are employees under common law. Paragraph (1) of the new subsection (c) defines the term "employee" to include, for any taxable year, a self-employed individual.

(2) *Definition of self-employed individual.*—Paragraph (2) of the new subsection (c) defines the term "self-employed individual" to mean an individual who has self-employment earnings (as defined in sec. 401(c)(3)) for the taxable year.

(3) *Definition of self-employment earnings.*—Paragraph (3) of the new subsection (c) contains a definition of self-employment earnings. Such term means the net earnings from self-employment (as defined in sec. 1402(a) of the code) determined with certain modifications. The first of these modifications provides that doctors and certain ministers, who are not subject to the tax on self-employment income, shall be treated, for this purpose, as being engaged in a trade or business from which net earnings from self-employment are derived. The second modification provides that certain salesmen described in section 3121(d)(3) of the code who are not employees but who are not subject to the tax on self-employment income shall be similarly treated. The third modification provides that amounts which are not otherwise includible in gross income shall not be included in an individual's net earnings from self-employment.

(4) *Definition of "owner-employee."*—Certain of the provisions of the bill are applicable only to owner-employees or to plans covering owner-employees. Paragraph (4) of the new subsection (c) defines the term "owner-employee" to mean a self-employed individual who—

(A) derives self-employment earnings from a trade or business carried on by him, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

(5) *Definition of "employer."*—In order to qualify under section 401, a plan must be a plan of an employer. Paragraph (5) of the new subsection (c) provides that, for this purpose, a self-employed individual who carries on a trade or business shall be treated as his own employer. Similarly, a partnership shall be treated as the employer of its partners who are self-employed individuals.

Section 401(d)

Paragraph (3) of section 2 of the bill also adds a new subsection (d) to section 401, which sets forth additional requirements which must be met in order for a trust forming part of a pension or profit-sharing plan covering owner-employees to qualify under section 401.

(1) *Trustee must be a bank.*—Paragraph (1) of the new subsection (d) provides that, in the case of a trust which is created on or after the date of the enactment of the bill, or which was created before such date but is not exempt as a qualified trust on the day before such date, the trustee must be a bank. However, paragraph (1) provides that a person (including the employer) other than a bank may be granted, under the trust instrument, the power to direct the investment of the trust funds. Paragraph (1) is not applicable to a trust created or organized outside the United States before the date of the enactment of the bill if, under section 402(c), such trust is treated as exempt from taxation under section 501(a) on the day before such date. Such paragraph (1) defines the term "bank" to mean (A) a bank as defined in section 581, and (B) a corporation which under the laws of the State of its incorporation is subject to supervision and examination by the Commissioner of Banking or similar officer, and (C) in the case of a foreign trust, a bank or trust company, wherever incorporated, exercising fiduciary powers and subject to supervision and examination by governmental authority.

(2) *Time of distribution.*—Paragraph (2) of the new subsection (d) provides that, under the plan, no benefits may be paid to any owner-employee prior to his attaining age 59½, except in the case of his disability (within the meaning of sec. 213(g)(3) of the code).

(3) *Vesting.*—Paragraph (3) of the new subsection (d) provides that, in the case of a plan to which section 401(a)(10) applies (i.e., a plan of an employer with more than three employees which covers one or more owner-employees), the employees' rights to or derived from the contributions under the plan must be nonforfeitable at the time such contributions are paid to or under the plan.

(4) *Definite contribution formula.*—Paragraph (4) of the new subsection (d) provides that a profit-sharing plan covering an owner-employee must provide a definite formula for determining contributions to be made to the trust by the employer on behalf of employees (other than owner-employees). Because of the limitations in section 404 on the amount that may be deducted for contributions on behalf of an owner-employee, the plan need not provide a definite formula for determining the contributions to be made on behalf of owner-employees.

(5) *Ratio of contributions; coordination with social security.*—Paragraph (5) of the new subsection (d) provides that a plan, to which section 401(a)(10) applies, may not permit a ratio of employer con-

tributions to compensation, in the case of an owner-employee, to exceed the ratio of employer contributions to compensation, in the case of other employees. Such paragraph (5) provides that the term "compensation" means total compensation, or basic or regular rate of compensation, whichever may be specified in the plan. In the case of a self-employed individual, the terms "total compensation" and "basic or regular rate of compensation" have the meaning assigned to them in section 401(a)(5). For purposes of determining whether the contributions by the employer meet the prescribed ratio, paragraph (5)(B) of the new subsection (d) provides that taxes paid under section 3111 (relating to tax on employers) with respect to an employee may be taken into account as contributions by the employer for such employee under the plan, if—

(A) of the contributions deductible under section 404 for the taxable year, not more than one-third is deductible by reason of contributions by the employer for owner-employees; and

(B) taxes paid by the owner-employees under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employees but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer for such owner-employees.

(6) *Excess contributions.*—Paragraph (6) of the new subsection (d) provides that the plan must not permit—

(A) contributions to be made by an employer for any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year;

(B) in the case of a plan (or, if sec. 401(a)(11) applies, the portion of a plan) which covers only owner-employees, contributions to be made in excess of those which are deductible under section 404 for the taxable year; and

(C) if a distribution under the plan is made to any owner-employee before such owner-employee attains the age of 59½ or becomes disabled, contributions to be made on behalf of such owner-employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

(7) *Distributions after death.*—Under paragraph (7) of the new subsection (d), the plan must provide that, after the death of an owner-employee, his interest in the plan must be either distributed to his beneficiary within 5 years or used within that period to purchase an immediate annuity for his beneficiary.

(8) *Repayment of excess contributions.*—Paragraph (8) of the new subsection (d) provides that, under the plan—

(A) any excess contribution (as defined in sec. 401(e)(1)), together with the income attributable thereto, is (except in the case of a willfully made excess contribution) to be repaid to the owner-employee by or for whom such excess contribution was made;

(B) if for any taxable year the plan does not, by reason of section 401(e)(2)(A), meet (for purposes of sec. 404) the requirements of section 401(d) with respect to an owner-employee, the income for the taxable year attributable to the interest of such owner-employee under the plan is to be paid to such owner-employee; and

(C) the entire interest of an owner-employee is to be repaid to him when required by section 401(e)(2)(E) (relating to willful excess contributions).

(9) *More than one trade or business.*—Paragraph (9)(A) of the new subsection (d) provides that, if the plan covers an owner-employee who controls, or two or more owner-employees who together control, the trade or business with respect to which the plan is established, and who also control as an owner-employee or as owner-employees one or more other trades or businesses, such plan and the plans (if any) established by such other trades or businesses must constitute an overall plan which meets the nondiscrimination requirements of section 401(a) (3) and (4), to the extent required by the new paragraph (10) or (11) of section 401(a), with respect to the employees of all such trades or businesses. In determining whether section 401(a) (10) or (11) applies, the employees of all the trades or business shall be taken into account.

Paragraph (9)(B) of the new subsection (d) provides that an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

(i) own the entire interest in an unincorporated trade or business, or

(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of determining his ownership interest, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-employee, or such two or more owner-employees, are considered to control within the meaning of paragraph (9)(B).

(10) *Contributions limited to the self-employment earnings from the trade or business.*—Paragraph (10) of the new subsection (d) provides that, under the plan, contributions on behalf of any owner-employee may be made only with respect to self-employment earnings of such owner-employee derived from the trade or business with respect to which the plan is established.

Section 401(e)

Paragraph (3) of section 2 of the bill also adds a new subsection (e) to section 401, which contains a definition of "excess contribution" and which sets forth the consequences of making such an excess contribution.

(1) *Definition of "excess contribution."*—Paragraph (1) of the new subsection (e) defines the term "excess contribution" to mean—

(A) if, in the taxable year, contributions are made under the plan only by or for owner-employees, of if the plan is one to which section 401(a)(11) applies, so much of any contribution made by or for any owner-employee as is not deductible under section 404 for the taxable year; or

(B) if, in the taxable year, contributions are made under the plan on behalf of both owner-employees and other employees and section 401(a)(11) does not apply to such plan—

(i) so much of any contribution made by an employer for any owner-employee as (without regard to the new subsec-

tion (e)) is not deductible under section 404 for the taxable year;

(ii) so much of any contribution as is made by an owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees; and

(iii) so much of any contribution made by an owner-employee (as an employee) as exceeds the lesser of $2,500 or 10 percent of his self-employment earnings for such taxable year derived by such owner-employee from the trade or business (or trades or businesses) with respect to which the plan is established; and

(C) any contribution made by or for an owner-employee in any taxable year for which, under section 401(e)(2) (A) or (E), the plan does not (for purposes of sec. 404) meet the requirements of section 401(d) with respect to such owner-employee.

Such paragraph (1) provides, however, that the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary of the Treasury or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account in determining the amount of any contribution for purposes of determining whether such contribution is an excess contribution.

(2) *Effect of excess contribution.*—Paragraph (2)(A) of the new subsection (e) provides that, if an excess contribution (other than a willful excess contribution to which sec. 401(e)(2)(E) applies) is made by or for an owner-employee in any taxable year, the plan with respect to which such excess contribution is made shall, except as provided in section 401(e)(2) (C) and (D), be considered, for purposes of section 404, as not meeting the requirements of section 401(d) with respect to such owner-employee for the taxable year and for all succeeding taxable years. In any year when an otherwise exempt trust forming part of a plan is (pursuant to par. (2)(A)) considered, for purposes of section 404, as not meeting the requirements of section 401(d) with respect to an owner-employee, the earnings of such trust (including those attributable to the interest of the owner-employee with respect to whom the excess contribution was made) shall remain exempt from tax in the hands of the trust. However, the trust shall not be considered exempt for purposes of deducting any contributions made by or for the owner-employee with respect to whom the excess contribution was made.

Paragraph (2)(B) of the new subsection (e) provides that, for any taxable year for which a plan does not meet the requirements of section 401(d) with respect to an owner-employee by reason of paragraph (2)(A), such owner-employee shall currently include in his gross income the income for such year attributable to his interest in the plan.

Paragraph (2)(C) of the new subsection (e) provides that paragraph (2)(A) (and, consequently, paragraph (2)(B)) shall not apply to an excess contribution with respect to any taxable year if (on or before the close of the 6-month period beginning on the day on which the Secretary or his delegate sends by certified or registered mail, to the trust, insurance company, or other person to whom such excess contribution was paid, notice of the amount of such excess contribution) the amount of such excess contribution, and the income attributable

thereto, is repaid to the owner-employee by or for whom such excess contribution was made. Such paragraph (2)(C) further provides that, if the contribution is an excess contribution by reason of exceeding the deduction limitations under section 404, the notice required to be sent by the Secretary or his delegate shall not be mailed prior to the time that the amount of the tax under chapter 1 of the Internal Revenue Code of the owner-employee to whom the excess contribution is to be repaid has been finally determined for the taxable year in which such excess contribution was made.

Paragraph (2)(D) of the new subsection (e) provides that, if an excess contribution, together with the income attributable thereto, is not repaid within the 6-month period, paragraph (2)(A) shall not apply to any taxable year beginning with the taxable year in which the trust, insurance company, or other person to whom such excess contribution was paid repays the amount of such excess contribution to the owner-employee by or for whom such excess contribution was made, and also pays to such owner-employee the amount of income attributable to the interest of such owner-employee which, under paragraph (2)(B), has been included in such owner-employee's gross income for any prior taxable year.

(3) *Special rule if excess contribution was willfully made.*—Paragraph (2)(E) of the new subsection (e) provides that, if an excess contribution made by or for an owner-employee is determined to have been willfully made, then, instead of applying the provisions of section 401(e)(2) (A), (B), (C), and (D)—

(i) there shall be distributed to the owner-employee by or for whom such excess contribution was willfully made his entire interest in all plans in which he is a participant as an owner-employee; and

(ii) contributions may not be made by or for such owner-employee to any plan in which he is a participant as an owner-employee for the taxable year in which it is determined that such excess contribution was willfully made and for the 5 taxable years following such taxable year.

Thus, when it has been determined that an excess contribution has been willfully made to a plan by or for an owner-employee, such owner-employee's entire interest in all plans in which he is a participant as an owner-employee must be distributed to him and he may not participate in any plan with respect to which he is an owner-employee for the taxable year of the determination and for the 5 succeeding taxable years.

(4) *Statute of limitations.*—Paragraph (2)(F) of the new subsection (e) provides that, in any case in which a plan does not meet the requirements of section 401(d) with respect to an owner-employee by reason of paragraph (2)(A), the period for assessing any deficiency arising by reason of—

(i) the disallowance of any deduction under section 404 because such plan does not meet the requirements of section 401(d) with respect to an owner-employee by or for whom an excess contribution was made, or

(ii) the inclusion, under paragraph (2)(B), in gross income of such owner-employee of the income attributable to his interest under a plan

for the taxable year in which such excess contribution was made or for any succeeding taxable year shall not expire prior to 1 year after the close of the 6-month period referred to in paragraph (2)(C).

Section 401(f)

Under present law, section 401(a) of the code relates only to trusts which form part of pension, profit-sharing, and stock-bonus plans. Paragraph (3) of section 2 of the bill also adds a new subsection (f) to section 401, which permits certain custodial accounts to qualify under section 401(a) if they form a part of qualified plans. Under the new subsection (f), a custodial account shall be treated as a qualified trust, if—

(1) such custodial account satisfies all the requirements which must be satisfied by a qualified trust;

(2) the custodian is a bank (as defined in section 581);

(3) the investment of the funds in such account (including all earnings) is to be made solely in regulated investment company stock with respect to which an employee is the beneficial owner (treating as subject to this requirement all capital gain dividends and any refund to the custodian under section 852(b)(3)(D)(ii) of the code); and

(4) the custodian or its nominee is the shareholder of record of all stock held in the account.

For purposes of the code, in the case of a custodial account treated as a qualified trust under section 401 by reason of the new section 401(f), the custodian of such account is to be treated as the trustee thereof.

Paragraph (2) of the new subsection (f) defines "regulated investment company" to mean a domestic corporation (A) which is a regulated investment company within the meaning of section 851(a), and (B) which issues only redeemable stock.

Section 401(g)

Under present law, there are certain provisions applicable to annuity contracts purchased by a qualified trust or under a qualified nontrusteed plan. Paragraph (3) of section 2 of the bill also adds a new subsection (g) to section 401 which provides that, for purposes of sections 401, 402, 403, and 404, the term "annuity" includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a-2), which is nontransferable.

SECTION 3. DEDUCTIBILITY OF CONTRIBUTIONS TO PLANS

Section 3 of the bill amends section 404 of the Internal Revenue Code of 1954 to allow the deduction of contributions made by or for self-employed individuals who are covered under qualified plans. In addition, section 404 is amended to provide limitations on the amount that may be deducted with respect to contributions by or for self-employed individuals who are owner-employees.

Section 404(a)

(1) *Annuity plans.*—Section 404(a)(2) allows, within the applicable limitations, the deduction of employer contributions paid toward the purchase of retirement annuities if such purchase is a part of a plan which meets the requirements of section 401(a) (3), (4), (5), and (6);

and if certain other conditions are met. Subsection (a)(1) of section 3 of the bill amends section 404(a)(2) to provide that the annuity plan must, in addition to meeting the present requirements, also meet the requirements in the new paragraphs (7), (8), (9), and (10) or (11) of section 401(a) and, if the plan covers owner-employees, the requirements of the new section 401(d) (2), (3), (5), (6), (7), (8), (9), and (10). Thus, a qualified annuity plan is, in general, subject to the same requirements as is a qualified pension, profit-sharing, or stock-bonus plan.

(2) *Inclusion of self-employed.*—Subsection (a)(2) of section 3 of the bill adds a new paragraph (8) to section 404(a), which allows the deduction under section 404(a) of contributions to a qualified plan covering self-employed individuals. To accomplish this purpose, the new paragraph (8) provides that, for purposes of applying section 404 to a qualified pension, annuity, or profit-sharing plan covering self-employed individuals—

(A) the term "employee" is defined to include a self-employed individual within the meaning of section 401(c)(2), and the employer of such a self-employed individual is defined to mean the person treated as his employer under section 401(c)(5);

(B) the term "self-employment earnings" has the meaning assigned to it by section 401(c)(3);

(C) the contributions to such a plan by or for a self-employed individual shall be considered to satisfy the conditions of section 162 or section 212 to the extent that such contributions do not exceed the self-employment earnings of such individual derived from the trade or business with respect to which such plan is established. However, contributions by or for self-employed individuals which are allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance are not considered to satisfy the conditions of section 162 or section 212 and, therefore, are not deductible under section 404; and

(D) all references in section 404 to the term "compensation" shall, in the case of a self-employed individual, be considered a reference to the self-employment earnings such individual derived from the trade or business with respect to which the plan is established.

(3) *Plans covering owner-employees.*—Subsection (a)(2) of section 3 of the bill also adds a new paragraph (9) to section 404(a), which provides special rules for computing the limitations on the amounts deductible for contributions under a qualified pension, annuity, or profit-sharing plan covering owner-employees.

Subparagraph (A) of the new paragraph (9) provides that the limitations in paragraphs (1), (2), (3), and (7) of section 404 (a) shall be computed, with respect to employees (other than owner-employees), as if such employees were the only employees covered under the plan. For example, if a qualified profit-sharing plan covers both owner-employees and other employees, the amount deductible under section 404(a)(3) with respect to contributions on behalf of such other employees is 15 percent of the compensation paid to such other employees if there are no carryovers for such year.

Subparagraph (B) of the new paragraph (9) provides that the limitations in paragraphs (1), (2), (3), and (7) of section 404(a), with

respect to contributions under a qualified plan on behalf of owner-employees, shall be computed—

(i) as if such owner-employees are the only employees covered under the plan; and

(ii) without regard to the carryover provisions contained in section 404(a)(1)(D), the second and third sentences of section 404(a)(3), and the second sentence of section 404(a)(7).

Subparagraph (C) of the new paragraph (9) provides that the amounts which are otherwise deductible under section 404(a) with respect to contributions by or for an owner-employee shall not exceed the additional limitations provided in section 404(e).

The new paragraph (9) further provides that, for purposes of section 404, the term "owner-employee" has the meaning assigned to it by section 401(c)(4).

Section 404(e)

Subsection (b) of section 3 of the bill adds to section 404 a new subsection (e), which provides additional limitations on amounts which may be deducted with respect to contributions on behalf of owner-employees.

(1) *Special limitations for owner-employees.*—Paragraph (1) of the new subsection (e) provides the additional limitations which are applicable in determining the amount that may be deducted with respect to contributions under a qualified plan on behalf of owner-employees. Under paragraph (1), the amounts deductible under section 404(a) in any taxable year with respect to contributions on behalf of such owner-employees shall not exceed—

(A) except as provided in section 404(e)(1)(B), $2,500, or 10 percent of the self-employment earnings derived by such owner-employee from the trade or business with respect to which the plan is established, whichever is the lesser; or

(B) in the case of a plan to which section 401(a)(10) applies, the maximum amount of contributions permitted to be made on behalf of such owner-employee under section 401(d)(5).

(2) *Overall limitation.*—Paragraph (2) of the new subsection (e) provides that in any taxable year in which amounts are deductible under two or more plans (whether established with respect to the same trade or business or different trades or businesses) on behalf of an individual who is an owner-employee with respect to such plans, the aggregate amount deductible for such taxable year under such plans with respect to contributions on behalf of such owner-employee shall not exceed whichever of the following amounts is the greater:

(i) $2,500, or

(ii) the sum of the amounts so contributed under all such plans to which section 401(a)(10) applies to the extent that, with respect to each such plan, the amount contributed does not exceed the amount described in section 404(e)(1)(B).

The overall limitation in paragraph (2) has no application with respect to contributions made under a plan on behalf of an employee who is not an owner-employee of the trade or business with respect to which the plan is established, even though such employee may be covered as an owner-employee under a plan or plans established by other trades or businesses.

Paragraph (2)(B) of the new subsection (e) provides that, in any case when paragraph (2)(A) reduces the amounts which are otherwise deductible under section 404 with respect to contributions made on behalf of an owner-employee under two or more plans, the portion of such reduced amount which is deductible under each plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(3) *Contribution allocable to insurance protection.*—Paragraph (3) of the new subsection (e) provides that the special limitations in section 404(e) are not applicable with respect to contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance.

Section 404(f)

Subsection (b) of section 3 of the bill also adds to section 404 a new subsection (f), which provides that, for purposes of section 404, any amount paid, directly or indirectly, by an owner-employee in repayment of any loan on an insurance policy which, under section 72 (m)(4)(B), was treated as an amount received under a contract, shall be treated as a contribution to which section 404 (including the limitations therein) applies on behalf of such owner-employee.

SECTION 4. TAXABILITY OF DISTRIBUTIONS

Section 4 of the bill amends section 72 of the Internal Revenue Code of 1954 to provide rules for the taxation of amounts distributed under qualified plans to self-employed individuals or the beneficiaries of such individuals.

Section 72(d)

Existing section 72(d) of the code provides a special rule for the taxation of an annuity receivable by an employee when the aggregate amount receivable by the employee under the terms of the contract during the 3-year period beginning on the date on which the amount is first received under the contract as an annuity is equal to or greater than the consideration for the contract contributed by the employee. Subsection (a) of section 4 of the bill amends section 72(d)(2) to provide that, for purposes of section 72(d), any contribution which is made with respect to the contract while the employee is a self-employed individual and which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee. This amendment merely makes clear that, as in the case of qualified plans established by corporations, a self-employed individual may not treat as consideration for the contract contributed by the employee any contributions under the plan for which deductions were allowed and which, consequently, are considered employer contributions. Moreover, under the new section 72(m)(2), contributions on behalf of a self-employed individual which are used to purchase life, accident, health, or other insurance are not, for purposes of section 72(d), included in the employee's basis for the contract.

Section 72(m)

Subsection (b) of section 4 of the bill adds to section 72 a new subsection (m), which provides special rules applicable to the taxation of employee annuities and distributions under employee plans.

(1) *Amounts received before annuity starting date.*—Paragraph (1) of the new subsection (m) provides that any amounts which are received under an annuity, endowment, or life insurance contract before the annuity starting date and which are not received as an annuity (within the meaning of sec. 72(e)(2)) shall be included in the recipient's gross income for the taxable year in which received to the extent that—

(A) such amounts, plus amounts theretofore received under the contract and includible in gross income under such paragraph (1), do not exceed

(B) the aggregate premiums or other consideration paid for the contract on behalf of an employee while such employee was an owner-employee (as defined in sec. 401(c)(4)) which were allowed as deductions under section 404 for the taxable year and all prior taxable years. For this purpose, the aggregate premiums or other consideration paid for the contract does not include any portion of such premiums or other consideration which is properly allocable (as determined under regulations prescribed by the Secretary or his delegate) to the cost of life, accident, health, or other insurance.

Such paragraph (1) further provides that any amounts received under an annuity, endowment, or life insurance contract before the annuity starting date which are not received as an annuity and which are not includible in gross income under such paragraph (1) shall be subject to the provisions of section 72(e).

The provisions of paragraph (1) may be illustrated by the example of a self-employed individual who receives $8,000 as a distribution under a qualified pension plan before the annuity starting date. At the time of such distribution, $10,000 had been contributed and deducted under the plan on behalf of such individual while he was not an owner-employee and $5,000 had been contributed and deducted under the plan on his behalf while he was an owner-employee. In addition, such individual had contributed $2,000 on his own behalf under the plan. Of the $8,000, $5,000 (the amount contributed and deducted on behalf of the individual while he was an owner-employee) is includible in gross income under paragraph (1). Of the remaining $3,000, $1,000 (the amount in excess of the individual's contributions on his own behalf) is includible in gross income under section 72(e).

(2) *Computation of consideration paid by a self-employed individual.*—Paragraph (2) of the new subsection (m) provides that in computing—

(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of section 72(c)(1)(A),

(B) the consideration for the contract contributed by the employee for purposes of section 72(d)(1), and

(C) the aggregate premiums or other consideration paid for purposes of section 72(e)(1)(B),

any amount allowed as a deduction with respect to the contract under section 404 while the employee was a self-employed individual shall be treated as consideration contributed by the employer. Such paragraph (2) further provides that the amounts described in paragraph (2) (A), (B), and (C) shall not include any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is allocable (as determined under regula-

tions prescribed by the Secretary of the Treasury or his delegate) to the cost of life, accident, health, or other insurance.

Paragraph (2) merely makes it clear that there shall not be included in an employee's, or in his beneficiary's, basis for a contract any amount which was contributed by such employee under a qualified plan and which was allowed as a deduction under section 404. In addition, under paragraph (2), there shall not be included in the basis of any contract the amount of any premiums or other consideration paid to purchase for an employee while he was an owner-employee any life, accident, health, or other insurance. Present law is to be applied in determining whether an amount to which paragraph (2) does not apply should be included in the basis of a contract.

(3) *Life insurance contracts.*—Paragraph (3) of the new subsection (m) is applicable to any life insurance contract—

(i) which is purchased as part of a qualified annuity plan described in section 403(a), or

(ii) which is purchased by a qualified trust, if the proceeds of such life insurance contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

Paragraph (3)(B) provides that any contributions to such a qualified annuity plan or such a qualified trust allowed as a deduction under section 404, and any income of such a qualified trust, which are determined (in accordance with regulations prescribed by the Secretary or his delegate) to have been applied to purchase the life insurance protection under a life insurance contract to which paragraph (3) applies are includible in the gross income of the employee for whom such protection is purchased for the taxable year when such contributions, or such income, are so applied. In the case of the death of an employee insured under a life insurance contract to which paragraph (3) applies, an amount equal to the cash surrender value of such contract immediately before the death of the employee shall be treated as a payment under the qualified plan or trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under section 72 and shall be treated as provided in section 101. The provisions of paragraph (3) are rules presently contained in the regulations under the Internal Revenue Code of 1954.

(4) *Amounts constructively received.*—Paragraph (4)(A) of the new subsection (m) provides that, if during any taxable year an owner-employee assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified trust or any portion of the value of a contract purchased as part of a qualified annuity plan, such portion shall be treated as having been received in such taxable year by such owner-employee as a distribution from such trust or as an amount received under such contract. Paragraph (4)(B) provides that, if during any taxable year an owner-employee receives, directly or indirectly, any amount from an insurance company as a loan under a contract purchased by a qualified trust or purchased as a part of a qualified annuity plan, and issued by such insurance company, the amount of such loan is to be treated as an amount received under the insurance contract in such taxable year.

(5) *Penalties applicable to certain amounts received by owner-employees.*—Paragraph (5) of the new subsection (m) provides a penalty tax on certain amounts received by an owner-employee under a

qualified trust or annuity plan. Paragraph (5)(A) provides that the penalty tax is applicable—

(i) to amounts (other than any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution) which are received under a qualified pension, annuity, or profit-sharing plan by an individual, who is, or has been, an owner-employee, before such individual attains the age of 59½, for any reason other than the individual's becoming disabled (within the meaning of sec. 213(g)(3) of the code), but only to the extent that such amounts are attributable to the contributions paid on behalf of such individual (whether or not paid by him) while he was an owner-employee;

(ii) to amounts which are received under such a qualified plan at any time by an individual who is, or has been, an owner-employee, or by the successor of such individual, but only to the extent that such amounts are determined, under regulations prescribed by the Secretary or his delegate, to exceed the benefits provided for such individual under the plan formula; and

(iii) to amounts which are received by reason of the distribution under the provisions of section 401(e)(2)(E) (relating to willfully made excess contributions) by an individual who is, or has been, an owner-employee of his entire interest in all such qualified plans.

The penalty tax is applicable to such amounts even though, at the time they are received, the recipient is not an owner-employee. In the case of an early distribution described in paragraph (5)(A)(i), the penalty tax is applicable to only so much of the distribution as is attributable to contributions paid on behalf of the recipient while he was an owner-employee. However, the penalty tax is applicable to the entire amount, to the extent it exceeds the benefits under the plan formula, received by an employee (or by the successor of an employee) who is, or has been, an owner-employee, even though a portion of such amount may be attributable to contributions made on behalf of such employee while he was not an owner-employee.

Paragraph (5)(B) provides that, if the aggregate of the amounts to which the penalty tax is applicable received by any person in his taxable year equals or exceeds $2,500, the increase in his tax for that taxable year attributable to the receipt of such amounts shall not be less than 110 percent of the aggregate increase in taxes, for that taxable year and the four immediately preceding taxable years, which would have resulted if such amounts had been included in such person's gross income ratably over such taxable years. If deductions had been allowed under section 404 for contributions paid on behalf of such person while he is an owner-employee for a number of prior taxable years less than four, paragraph (5)(B)(i) shall be applied by taking into account the number of taxable years immediately preceding the taxable year in which the amount was so received equal to such lesser number.

Under paragraph (5)(C), if the aggregate of the amounts to which the penalty tax is applicable received by a person in his taxable year is less than $2,500, the increase in tax attributable to the receipt of such amounts shall be 110 percent of the increase computed without regard to this penalty tax.

Paragraph (5)(D) provides that the penalty tax shall not apply to any amount which is taxed, under section 402(a)(2) or section 403(a)(2), at capital gains rates. On the other hand, since a distribution required as a result of a determination that a willful excess contribution has been made on behalf of an owner-employee is not a distribution on account of separation from service or death, the penalty tax will, in all cases, be applicable to such a distribution.

Paragraph (5)(E) provides that section 72(n)(3) is to be applied for purposes of computing the taxable income for taxable years to which paragraph (5) applies.

Paragraph (6) of the new subsection (m) provides that, for purposes of section 72, the term "owner-employee" has the meaning assigned to it by section 401(c)(4).

Section 72(n)

Subsection (b) of section 4 of the bill also adds to section 72 a new subsection (n), which provides special tax treatment with respect to certain total distributions received under a qualified plan.

(1) Paragraph (1) of the new subsection (n) sets forth the distributions to which the special tax treatment in section 72(n) applies. In the case of a qualified pension or profit-sharing trust, the special tax treatment is applicable to amounts distributed to a distributee, if such amounts represent the total distributions payable to the distributee with respect to an employee and if such amounts are paid to the distributee within 1 taxable year of the distributee—

(i) on account of the employee's death,

(ii) after the employee has attained the age of 59½ years, or

(iii) after the employee has become disabled (within the meaning of sec. 213(g)(3) of the code).

In the case of a qualified annuity plan, the special tax treatment is applicable to amounts paid to a payee, if such amounts represent the total amounts payable to the payee with respect to an employee and if such amounts are paid to the payee within 1 taxable year of the payee—

(i) on account of the employee's death,

(ii) after the employee has attained the age of 59½ years, or

(iii) after the employee has become disabled (within the meaning of sec. 213(g)(3)).

For the special tax treatment to be applicable to a distributee or payee with respect to a distribution of an employee's interest in a qualified plan, it is not necessary that there also be distributed within the 1-year period any portion of the employee's interest which is payable to another payee or distributee.

The special tax treatment provided by the new section 72(n) is, under paragraph (1)(C), applicable only with respect to so much of any distribution or payment as is attributable to contributions made under a qualified plan by or for a self-employed individual. If an employee receives a distribution or payment of his own interest in a qualified plan or trust, the special tax treatment is applicable to such distribution or payment only if contributions which were allowed as a deduction under section 404 have been made by or for such employee while he was a self-employed individual for five or more taxable years prior to the taxable year in which such distribution is paid. In addition, the special tax treatment is not applicable to amounts to which the penalty tax in section 72(m)(5) is applicable.

(2) Paragraph (2) of the new subsection (n) provides that, in any case when the special tax treatment applies, the tax attributable to the amounts to which the new subsection (n) applies for the taxable year for which such amounts are received is not to exceed whichever of the following is the greater:

(A) five times the increase in tax which would result from the inclusion in gross income of the recipient of 20 percent of so much of the amount so received as is includible in gross income; or

(B) five times the increase in tax which would result if the taxable income of the recipient for such taxable year equaled 20 percent of the amount of the taxable income of the recipient for such taxable year determined under section 72(n)(3)(A).

(3) Paragraph (3) of the new subsection (n) provides that (notwithstanding sec. 63) for purposes only of computing the tax under chapter 1 of the Internal Revenue Code of 1954 attributable to amounts to which the new subsection (n) or section 72(m)(5) (relating to the penalty tax in the case of certain distributions) applies and which are includible in gross income—

(A) the taxable income of the recipient for the taxable year of receipt is to be treated as being not less than the amount by which (i) the aggregate of such amounts so includible in gross income exceeds (ii) the amount of the deductions allowed for such taxable year under section 151 (relating to deductions for personal exemptions); and

(B) in making ratable inclusion computations under paragraph (5)(B) of section 72(m), the taxable income of the recipient for any taxable year involved in such ratable inclusion is to be treated as being not less than the amount required by such paragraph (5)(B) to be treated as includible in gross income for such taxable year.

In any case in which section 72(n)(3) results in an increase in taxable income for any taxable year, the resulting increase in the taxes imposed by section 1 or section 3 for such taxable year shall not be reduced by any credit under part IV of subchapter A of chapter 1 (other than sec. 31) of the Internal Revenue Code of 1954 which, but for this provision, would be allowable. Under paragraph (3), in no case is there subjected to tax under the penalty tax in section 72(m)(5) or the special tax treatment in section 72(n) amounts which represent a recipient's basis in the distribution.

The application of the rules in paragraph (3) of the new subsection (n) in the case of a total distribution to which the special tax treatment in the new section 72(n) applies may be illustrated by the following example: A, a sole proprietor, established a qualified pension trust to which he made annual contributions for 10 years of 10 percent of his self-employment earnings. A withdrew his entire interest in the trust during a taxable year for which, without regard to the distribution, he had a net operating loss and for which he is allowed under section 151 a deduction for one personal exemption. At the time of the withdrawal, A was 64 years old. The amount of the distribution that is includible in his gross income is $25,600. For purposes of determining the tax attributable to the $25,600, A's taxable income for the taxable year in which he received such amount is treated, under paragraph (3) of the new subsection (n), as being $25,000 ($25,600 minus $600 (the deduction allowed for his personal exemp-

tion)). Thus, under paragraph (2) of the new subsection (n), the tax attributable to the $25,600 would be 5 times the increase in tax which would result if the taxable income of A for the taxable year he received such amount equaled $5,000 (20 percent of his taxable income determined under paragraph (3) of the new subsection (n)).

The application of the rules in paragraph (3) of the new subsection (n) in the case of a distribution to which section 72(m)(5) applies may be illustrated by the following example: Assume the same facts as in the example in the preceding paragraph except that A was 55 years old (and not disabled) at the time of the withdrawal. In addition, A had a net operating loss for the taxable year immediately preceding the taxable year in which he received the $25,600. The other 3 taxable years involved in the computations under section 72(m)(5)(B) were years of substantial income. For purposes of determining A's increase in tax attributable to the receipt of the $25,600 (before the application of the spreading provisions in section 72(m)(5)(B)), A's taxable income for the year he received the $25,600 is treated, under paragraph (3)(A) of the new subsection (n), as being $25,000 ($25,600 minus $600). For purposes of determining whether 110 percent of the aggregate increase in taxes which would have resulted if 20 percent of the amount of the withdrawal had been included in A's gross income for the year of receipt and for each of the 4 preceding taxable years is greater (and thus is the amount of his increase in tax attributable to the receipt of the $25,600), A's taxable income for the taxable year of receipt, and for the immediately preceding taxable year, is treated, under paragraph (3)(B) of the new subsection (n), as being $5,120 ($25,600 divided by 5).

Section 402(a)

Existing section 402(a)(2) provides that certain total distributions from qualified trusts are taxable at capital gains rates. Subsection (c) of section 4 of the bill amends section 402(a)(2) to provide that the capital gains treatment is not applicable to distributions paid to any distributee to the extent such distributions are attributable to contributions made by or for an individual while he was a self-employed individual. In other words, in the case of an individual who was covered under a qualified plan both while he was an employee within the meaning of common law and while he was a self-employed individual, the capital gains treatment could only apply to that part of a distribution that is attributable to contributions made on his behalf while he was an employee within the meaning of common law.

Section 403(a)

Existing section 403(a) provides the tax treatment for distributions under qualified nontrusteed annuity plans. Subsection (d)(1) of section 4 of the bill amends section 403(a)(2)(A)(i) to provide that a qualified annuity plan must meet the new qualification requirements included by this bill in section 401 (a) and (d).

Existing section 403(a)(2) provides capital gains treatment for certain total distributions under qualified annuity plans. Subsection (d)(2) of section 4 of the bill amends section 403(a)(2)(A) to provide that the capital gains treatment shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made by or for an individual while he was a self-employed individual. This amendment applies similar treatment to distributions under

qualified annuity plans as the amendment made by subsection (c) of section 4 of the bill applies to distributions from qualified trusts.

Subsection (d)(3) of section 4 of the bill adds to section 403(a) a new paragraph (3) providing that, for purposes of section 403(a), the term "employee" includes a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual is the person treated as his employer under section 401(c)(5). This amendment merely makes it clear that a self-employed individual can participate in a qualified annuity plan.

SECTION 5. PLANS FOR PURCHASE OF U.S. BONDS

Section 5 of the bill adds a new section 405 to the Internal Revenue Code of 1954 to provide for the establishment of qualified bond purchase plans.

Section 405(a)

Subsection (a) of the new section 405 provides that a plan of an employer for the purchase for and distribution to his employees or their beneficiaries of U.S. bonds described in section 405(b) shall constitute a qualified bond purchase plan if—

(1) the plan meets the requirements of section 401(a) (other than pars. (1), (2) and (12)) and, if applicable, the requirements of section 401(d) (other than pars. (1), (6)(B), and (8)); and

(2) contributions under the plan are used solely to purchase for employees or their beneficiaries the U.S. bonds described in section 405(b).

A qualified bond purchase plan can be established by an employer for his employees without the creation of a trust but, if such a plan is established, only the special bonds can be purchased under the plan. A qualified trusteed plan can also purchase the special bonds together with other assets but the plan must qualify under section 401 as a pension or profit-sharing plan.

In general, a qualified bond purchase plan must meet the same qualification requirements as a qualified annuity plan. However, section 401(d) (6)(B) and (8) is not applicable to a qualified bond purchase plan and, consequently, there is no limit on the amount of contributions in excess of those which are deductible that may be made under the plan.

Section 405(b)

Subsection (b)(1) of the new section 405 describes the special bond which can be purchased under a qualified bond purchase plan. Such paragraph provides that such a bond is a bond issued under the Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary of the Treasury under the Second Liberty Bond Act—

(A) provides for payment of interest or investment yield only upon redemption;

(B) may be purchased only in the name of an individual;

(C) ceases to bear interest, or provide investment yield, not later than 5 years after the death of the individual in whose name it is purchased;

(D) may be redeemed before the death of the individual in whose name it is purchased only if such individual—

(i) has attained the age of 59½ years, or

(ii) has become disabled (within the meaning of sec. 213(g)(3)); and

(E) is not transferable.

Subsection (b)(2) of the new section 405 provides that bonds purchased under a qualified bond purchase plan must be purchased in the name of the employee for whom it is purchased.

Section 405(c)

Subsection (c) of the new section 405 provides that contributions paid by an employer to or under a qualified bond purchase plan shall be deductible in an amount determined under section 404(a) in the same manner and to the same extent as if such contributions were made to a qualified trust described in section 401(a) which is exempt from tax under section 501(a). Thus, for contributions to a qualified bond purchase plan to be deductible under section 405(c), all of the requirements of section 404 must be met. For example, the contributions must meet the requirements of section 162 or 212, and must be made (or deemed to have been made under sec. 404(a)(6)) in a taxable year of an employer which ends with or within a year of the bond purchase plan for which it qualifies under section 405. If the amount of the contributions to the qualified bond purchase plan are determined by reference to the profits of the employer, as in the case of a qualified profit-sharing plan, the amount deductible with respect to such contributions is determined under section 404(a)(3), relating to qualified profit-sharing plans. Moreover, such a bond purchase plan shall be considered a profit-sharing plan for purposes of the provision in section 404(a)(3) relating to a situation when contributions are made to two or more profit-sharing trusts. In other cases, the amount deductible with respect to contributions to a qualified bond purchase plan will be determined under section 404(a)(1). If the qualified bond purchase plan covers owner-employees, the amount deductible with respect to contributions to the plan is subject to the further limitations of section 404(e) applicable to owner-employees. Similarly, in the case of a qualified bond purchase plan covering owner-employees, the special rules in section 404(a)(9) for computing the limitations with respect to deductions for contributions under the plan shall be applicable. Thus, the carryover provisions of section 404(a) are not applicable with respect to contributions made under a qualified bond purchase plan by or for owner-employees.

Section 405(d)

Subsection (d)(1) of the new section 405 provides that no amount is includible in the gross income of a distributee at the time a bond described in section 405(b) is distributed to him under a qualified bond purchase plan or from a qualified trust. Upon the redemption of such a bond, however, the proceeds are subject to taxation under chapter 1 of the Internal Revenue Code of 1954. In applying chapter 1, for purposes of determining the amount of tax due, the provisions of sections 72 and 1232 shall not be applied. In other words, the bonds described in section 405(b) received under a qualified bond purchase plan or from a qualified trust are not subject to tax until they are redeemed. In addition, upon redemption, no part of the proceeds will be taxable at capital gains rates under section 1232.

Subsection (d)(2) of the new section 405 provides rules for determining the basis of any bond received by a distributee under a qualified bond purchase plan. If the bond was purchased for an employee within the meaning of common law, the basis of such bond shall be an amount equal to the amount of the contributions made under the plan by the employee himself which were used to purchase the bond. If the bond was purchased for an employee at a time when he was a self-employed individual, the basis of such bond is an amount equal to the amount of the contributions used to purchase the bond which were made by or for such employee and which were not allowed as a deduction under section 405(c). Such subsection (d)(2) further provides that the basis of a bond described in section 405(b) which is received by a distributee from a qualified trust shall be determined under regulations prescribed by the Secretary or his delegate.

Section 405(e)

Subsection (e) of the new section 405 provides that the capital gains treatment of section 402(a)(2) shall not apply to any of the bonds described in section 405(b) and that, for purposes of applying section 402(a)(2) to amounts distributed by a qualified trust, any such bonds distributed to any distributee and any such bonds to the credit of any employee shall not be taken into account. In other words, for purposes of applying section 402(a)(2), a distribution under a qualified trust may be considered a total distribution of an employee's interest in such trust even though the trust retains bonds described in section 405(b). In the case of a distribution from a qualified trust which qualifies for the capital gains treatment of section 402(a)(2) and which includes both bonds of the type described in section 405(b) and other property, the capital gains treatment will be applicable to such other property. In no case, however, will the capital gains treatment be applicable to the proceeds received as a result of the redemption of any of the bonds described in section 405.

Section 405(f)

Subsection (f) of the new section 405 provides that, for purposes of section 405, the term "employee" includes an individual who is a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual shall be the person treated as his employer under section 401(c)(5). Such subsection (f) has the effect of enabling the self-employed individual to participate in a qualified bond purchase plan to the same extent that he may participate in qualified pension, annuity, and profit-sharing plans.

Section 405(g)

Subsection (g) of the new section 405 provides that, at the time of the purchase of any of the bonds described in section 405, proof of such purchase shall be furnished in such form as will enable the purchaser, and the employee in whose name such bond is purchased, to comply with the provisions of section 405.

Section 405(h)

Subsection (h) of the new section 405 provides that the Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of section 405.

SECTION 6. PROHIBITED TRANSACTIONS

Section 6 of the bill amends section 503 of the Internal Revenue Code of 1954 to provide a special definition of the term "prohibited transaction" in the case of certain qualified employees' trusts covering owner-employees. This special definition is only applicable when the owner-employees covered by the qualified employees' trust control the trade or business with respect to which the trust is established.

Section 6 of the bill adds to section 503 a new subsection (j) which provides that, in the case of a trust described in section 401(a) which is part of a plan covering owner-employees (as defined in sec. 401(c)(4)) who control the trade or business with respect to which the plan is established, the term "prohibited transaction" means, in addition to the transactions described in section 503(c), any transaction in which such trust, directly or indirectly—

(A) lends any part of the corpus or income of the trust to;

(B) pays any compensation for personal services rendered to the trust to;

(C) makes any part of its services available on a preferential basis to; or

(D) acquires for the trust any property from, or sells any property to;

any person described in section 503(c) or to any such owner-employee, a member of the family (as defined in sec. 267(c)(4)) of any such owner-employee, or a corporation controlled by such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

For purposes of determining whether owner-employees covered under a qualified employees' trust control the trade or business with respect to which such trust is established, the rules in section 401(d)(9)(B) are to be applied.

Paragraph (2) of the new subsection (j) provides that, for purposes of the new definition of "prohibited transaction" in paragraph (1), the following rules are to apply with respect to a loan made before the date of the enactment of the bill which would be a prohibited transaction if made in a taxable year beginning after December 31, 1961:

(A) if any part of the loan is repayable prior to December 31, 1964, the renewal of such part of the loan for a period not extending beyond December 31, 1964, on the same terms, shall not be considered a prohibited transaction.

(B) if the loan is repayable on demand, the continuation of the loan beyond December 31, 1964, shall be considered a prohibited transaction.

SECTION 7. OTHER SPECIAL RULES, TECHNICAL CHANGES, AND ADMINISTRATIVE PROVISIONS

Section 7 of the bill provides certain technical amendments and administrative provisions.

Section 7(a) of the bill amends section 37 of the Internal Revenue Code of 1954, relating the retirement income credit, to make clear that any distribution to a self-employed individual under a qualified

pension, annuity, or profit-sharing plan, and any income derived by any person from the bonds described in section 405(b) received under a qualified bond purchase plan or from a qualified trust, may qualify as retirement income for purposes of such credit.

Section 7(b) of the bill amends section 62 of the Internal Revenue Code of 1954, relating to the definition of "adjusted gross income," to provide that, in computing adjusted gross income, there shall be allowed, in the case of a self-employed individual, the deductions allowed under sections 404 and 405 for contributions by or for such an individual to a qualified pension, annuity, profit-sharing, or bond-purchase plan.

Section 7(c) of the bill amends section 101(b) of the Internal Revenue Code of 1954, relating to employees' death benefits. Paragraph (1) of section 7(c) amends section 101(b) so that the rule applicable to distributions under a qualified annuity plan will only apply if the annuity plan meets the new qualification requirements of section 401 (a) and (d) applicable to annuity plans.

Paragraph (2) of section 7(c) amends section 101(b) by adding a new paragraph (3), which provides, in effect, that the death benefits exclusion provided by section 101(b) does not apply to amounts which are paid under a qualified pension, profit-sharing, or annuity plan, if such amounts are paid with respect to an individual who was a self-employed individual during any of the time he was covered by the plan.

Section 7(d) of the bill amends section 104(a) of the Internal Revenue Code of 1954, relating to compensation for injuries or sickness, to make clear that the exclusion of such section is not applicable to any benefits which are attributable to contributions to a qualified pension, annuity, or profit-sharing plan made by or for an individual while he was a self-employed individual, to the extent that such contributions were deductible under section 404.

Section 7(e) of the bill amends section 105 of the Internal Revenue Code of 1954, relating to amounts received under accident and health plans, by adding a new subsection (g) which provides that, for purposes of section 105, the term "employee" does not include an individual who is a self-employed individual within the meaning of section 401(c)(2). For example, if at the time an individual commences to receive benefits described in section 105 from a qualified pension plan, he is covered under such plan as a self-employed individual, such benefits do not qualify for the exclusion of section 105.

Section 7(f) of the bill amends section 172(d)(4) of the Internal Revenue Code of 1954, relating to net operating loss deductions, to make clear that any deduction under sections 404 or 405 attributable to contributions on behalf of a self-employed individual under a qualified employees' plan shall not be treated as attributable to the trade or business of such individual for purposes of section 172.

Section 7(g) of the bill makes conforming amendments to section 805 of the Internal Revenue Code of 1954, relating to pension plan reserves of life insurance companies.

Section 7(h) of the bill amends section 1361 of the Internal Revenue Code of 1954, relating to unincorporated business enterprises electing to be taxed as domestic corporations, to permit a partner or proprietor of such an unincorporated business to participate in a qualified pension, annuity, profit-sharing, or bond-purchase plan. However, for pur-

poses of applying all the provisions relating to such qualified plans, such a partner or proprietor shall be considered a self-employed individual and will be considered an employee only to the extent he is so considered under section 401(c)(2).

Section 7(i) of the bill amends section 2039 of the Internal Revenue Code of 1954, relating to exemption from gross estate of annuities under certain trusts and plans. Paragraph (1) of section 7(i) amends section 2039(c)(2) to provide that the exclusion of the value of an annuity under a qualified annuity plan will be applicable only if the annuity plan meets the additional qualification requirements of section 401 (a) and (d). Paragraph (2) of section 7(i) amends section 2039(c) by adding at the end thereof a new sentence which provides that, for purposes of section 2039(c), contributions or payments on behalf of the decedent while he was a self-employed individual within the meaning of section 401(c)(2) made under a qualified pension, annuity, or profit-sharing plan shall be considered to be contributions or payments made by the decedent. Accordingly, the estate tax exclusion of section 2039(c) is not applicable to the portion of a decedent's interest in a qualified plan which is attributable to contributions made by or for an individual while he was a self-employed individual.

Section 7(j) of the bill amends section 2517 of the Internal Revenue Code of 1954, relating to exclusion from gift tax in case of certain annuities under qualified plans, in the same manner as section 7(i) of the bill amends the estate tax exclusion with respect to qualified plans.

Sections 7 (k) and (l) of the bill amend section 3306(b)(5) of the Internal Revenue Code of 1954 (relating to the Federal Unemployment Tax Act) and section 3401(a)(12) of such code (relating to the withholding of income tax). These amendments make conforming changes and exclude from the definition of "wages" under such sections any payment made to, or on behalf of, an employee or his beneficiary under or to a bond-purchase plan which, at the time of such payment, is a qualified bond-purchase plan described in section 405(a).

Section 7(m) of the bill amends the Internal Revenue Code of 1954 to add a new section 6047, giving the Secretary or his delegate authority to require the furnishing of additional information which is necessary to administer the new provisions in this bill. Section 7(m) of the bill also amends section 7207 of the 1954 code to provide penalties for willfully furnishing false or fraudulent information.

SECTION 8. EFFECTIVE DATE

Section 8 of the bill provides that the amendments made by this bill will be applicable to taxable years beginning after December 31, 1961.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as introduced, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter A—Determination of Tax Liability

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PART IV—CREDITS AGAINST TAX

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SEC. 37. RETIREMENT INCOME.

(a) GENERAL RULE.— * * *

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(c) RETIREMENT INCOME.—For purposes of subsection (a), the term "retirement income" means—

(1) in the case of an individual who has attained the age of 65 before the close of the taxable year, income from—

(A) pensions and annuities *(including, in the case of an individual who is, or has been, a self-employed individual within the meaning of section 401(c)(2), distributions by a trust described in section 401(a) which is exempt from tax under section 501(a)),*

(B) interest,

(C) rents, [and]

(D) dividends, [or] *and*

(E) bonds described in section 405(b)(1) which are received under a qualified bond purchase plan described in section 405(a) or in a distribution from a trust described in section 401(a) which is exempt from tax under section 501(a), or

(2) in the case of an individual who has not attained the age of 65 before the close of the taxable year, income from pensions and annuities under a public retirement system (as defined in subsection (f)),

to the extent included in gross income without reference to this section, but only to the extent such income does not represent compensation for personal services rendered during the taxable year.

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Subchapter B—Computation of Taxable Income

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PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, AND TAXABLE INCOME

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SEC. 62. ADJUSTED GROSS INCOME DEFINED.

For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) TRADE AND BUSINESS DEDUCTIONS.—The deductions allowed by this chapter (other than by part VII of this subchapter) which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

(2) TRADE AND BUSINESS DEDUCTIONS OF EMPLOYEES.—

(A) REIMBURSED EXPENSES.—The decuctions allowed by part VI (sec. 161 and following) which consist of expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an employee, under a reimbursement or other expense allowance arrangement with his employer.

(B) EXPENSES FOR TRAVEL AWAY FROM HOME.—The deductions allowed by part VI (sec. 161 and following) which consist of expenses of travel, meals, and lodging while away from home, paid or incurred by the taxpayer in connection with the performance by him of services as an employee.

(C) TRANSPORTATION EXPENSES.—The deductions allowed by part VI (sec. 161 and following) which consist of expenses of transportation paid or incurred by the taxpayer in connection with the performance by him of services as an employee.

(D) OUTSIDE SALESMEN.—The deductions allowed by part VI (sec. 161 and following) which are attributable to a trade or business carried on by the taxpayer, if such trade or business consists of the performance of services by the taxpayer as an employee and if such trade or business is to solicit, away from the employer's place of business, business for the employer.

(3) LONG-TERM CAPITAL GAINS.—The deduction allowed by section 1202.

(4) LOSSES FROM SALE OR EXCHANGE OF PROPERTY.—The deductions allowed by part VI (sec. 161 and following) as losses from the sale or exchange of property.

(5) DEDUCTIONS ATTRIBUTABLE TO RENTS AND ROYALTIES.—The deductions allowed by part VI (sec. 161 and following), by section 212 (relating to expenses for production of income), and by section 611 (relating to depletion) which are attributable to property held for the production of rents or royalties.

(6) CERTAIN DEDUCTIONS OF LIFE TENANTS AND INCOME BENEFICIARIES OF PROPERTY.—In the case of a life tenant of property, or an income beneficiary of property held in trust, or an heir,

legatee, or devisee of an estate, the deduction for depreciation allowed by section 167 and the deduction allowed by section 611.

(7) *PENSION, PROFIT-SHARING, ANNUITY, AND BOND PURCHASE PLANS OF SELF-EMPLOYED INDIVIDUALS.—In the case of an individual who is a self-employed individual within the meaning of section 401(c)(2), the deductions allowed by section 404 and section 405(c) to the extent attributable to contributions made by or for such individual.*

Nothing in this section shall permit the same item to be deducted more than once.

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PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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SEC. 72. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS.

(a) GENERAL RULE FOR ANNUITIES.—Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

(b) EXCLUSION RATIO.—Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). This subsection shall not apply to any amount to which subsection (d)(1) (relating to certain employee annuities) applies.

(c) DEFINITIONS.—

(1) INVESTMENT IN THE CONTRACT.—For purposes of subsection (b), the investment in the contract as of the annuity starting date is—

(A) the aggregate amount of premiums or other consideration paid for the contract, minus

(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

(2) ADJUSTMENT IN INVESTMENT WHERE THERE IS REFUND FEATURE.—If—

(A) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals;

(B) the contract provides for payments to be made to a beneficiary (or to the estate of an annuitant) on or after the death of the annuitant or annuitants; and

(C) such payments are in the nature of a refund of the consideration paid,

then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the amount determined under paragraph (1). Such value shall be computed in accordance with actuarial tables prescribed by the Secretary or his delegate. For purposes of this paragraph and of

subsection (e)(2)(A), the term "refund of the consideration paid" includes amounts payable after the death of an annuitant by reason of a provision in the contract for a life annuity with minimum period of payments certain, but (if part of the consideration was contributed by an employer) does not include that part of any payment to a beneficiary (or to the estate of the annuitant) which is not attributable to the consideration paid by the employee for the contract as determined under paragraph (1)(A).

(3) EXPECTED RETURN.—For purposes of subsection (b), the expected return under the contract shall be determined as follows:

(A) LIFE EXPECTANCY.—If the expected return under the contract, for the period on and after the annuity starting date, depends in whole or in part on the life expectancy of one or more individuals, the expected return shall be computed with reference to actuarial tables prescribed by the Secretary or his delegate.

(B) INSTALLMENT PAYMENTS.—If subparagraph (A) does not apply, the expected return is the aggregate of the amounts receivable under the contract as an annuity.

(4) ANNUITY STARTING DATE.—For purposes of this section, the annuity starting date in the case of any contract is the first day of the first period for which an amount is received as an annuity under the contract; except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954.

(d) EMPLOYEES' ANNUITIES.—

(1) EMPLOYEE'S CONTRIBUTIONS RECOVERABLE IN 3 YEARS.—Where—

(A) part of the consideration for an annuity, endowment, or life insurance contract is contributed by the employer, and

(B) during the 3-year period beginning on the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity, the aggregate amount receivable by the employee under the terms of the contract is equal to or greater than the consideration for the contract contributed by the employee,

then all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded (under this paragraph and prior income tax laws) an amount equal to the consideration for the contract contributed by the employee. Thereafter all amounts so received under the contract shall be included in gross income.

[(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1), if the employee died before any amount was received as an annuity under the contract, the words "receivable by the employee" shall be read as "receivable by a beneficiary of the employee".]

(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1)—

(A) if the employee died before any amount was received as an annuity under the contract, the words "receivable by the employee" shall be read as "receivable by a beneficiary of the employee"; and

(B) any contribution made with respect to the contract while an individual is a self-employed individual within the meaning of section 401(c)(2) which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee.

(3) CROSS REFERENCE.—

For certain rules for determining whether amounts contributed by employer are includible in the gross income of the employee, see part I of subchapter D (sec. 401 and following, relating to pension, profit-sharing, and stock bonus plans, etc.).

(e) AMOUNTS NOT RECEIVED AS ANNUITIES.—

(1) GENERAL RULE.—If any amount is received under an annuity, endowment, or life insurance contract, if such amount is not received as an annuity, and if no other provision of this subtitle applies, then such amount—

(A) if received on or after the annuity starting date, shall be included in gross income; or

(B) if subparagraph (A) does not apply, shall be included in gross income, but only to the extent that it (when added to amounts previously received under the contract which were excludable from gross income under this subtitle or prior income tax laws) exceeds the aggregate premiums or other consideration paid.

For purposes of this section, any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity.

(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1), the following shall be treated as amounts not received as an annuity:

(A) any amount received, whether in a single sum or otherwise, under a contract in full discharge of the obligation under the contract which is in the nature of a refund of the consideration paid for the contract; and

(B) any amount received under a contract on its surrender, redemption, or maturity.

In the case of any amount to which the preceding sentence applies, the rule of paragraph (1)(B) shall apply (and the rule of paragraph (1)(A) shall not apply).

(3) LIMIT ON TAX ATTRIBUTABLE TO RECEIPT OF LUMP SUM.—If a lump sum is received under an annuity, endowment, or life insurance contract, and the part which is includible in gross income is determined under paragraph (1), then the tax attributable to the inclusion of such part in gross income for the taxable year shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of the taxpayer ratably over the taxable year in which received and the preceding 2 taxable years.

(f) SPECIAL RULES FOR COMPUTING EMPLOYEES' CONTRIBUTIONS.—In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other consideration paid, amounts con-

tributed by the employer shall be included, but only to the extent that—

(1) such amounts were includible in the gross income of the employee under this subtitle or prior income tax laws; or

(2) if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

(g) RULES FOR TRANSFEREE WHERE TRANSFER WAS FOR VALUE.—Where any contract (or any interest therein) is transferred (by assignment or otherwise) for a valuable consideration, to the extent that the contract (or interest therein) does not, in the hands of the transferee, have a basis which is determined by reference to the basis in the hands of the transferor, then—

(1) for purposes of this section, only the actual value of such consideration, plus the amount of the premiums and other consideration paid by the transferee after the transfer, shall be taken into account in computing the aggregate amount of the premiums or other consideration paid for the contract;

(2) for purposes of subsection (c)(1)(B), there shall be taken into account only the aggregate amount received under the contract by the transferee before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

(3) the annuity starting date is January 1, 1954, or the first day of the first period for which the transferee received an amount under the contract as an annuity, whichever is the later.

For purposes of this subsection, the term "transferee" includes a beneficiary of, or the estate of, the transferee.

(h) OPTION TO RECEIVE ANNUITY IN LIEU OF LUMP SUM.—If—

(1) a contract provides for payment of a lump sum in full discharge of an obligation under the contract, subject to an option to receive an annuity in lieu of such lump sum;

(2) the option is exercised within 60 days after the day on which such lump sum first became payable; and

(3) part or all of such lump sum would (but for this subsection) be includible in gross income by reason of subsection (e)(1).

then, for purposes of this subtitle, no part of such lump sum shall be considered as includible in gross income at the time such lump sum first became payable.

(i) JOINT AND SURVIVOR ANNUITIES WHERE FIRST ANNUITANT DIED IN 1951, 1952, OR 1953.—Where an annuitant died after December 31, 1950, and before January 1, 1954, and the basis of a surviving annuitant's interest in the joint and survivor annuity contract was determinable under section 113(a)(5) of the Internal Revenue Code of 1939, then—

(1) subsection (d) shall not apply with respect to such contract;

(2) for purposes of this section, the aggregate amount of premiums or other consideration paid for the contract is the basis of the contract determined under such section 113(a)(5);

(3) for purposes of subsection (c)(1)(B), there shall be taken into account only the aggregate amount received by the surviving annuitant under the contract before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

(4) the annuity starting date is January 1, 1954, or the first day of the first period for which the surviving annuitant received an amount under the contract as an annuity, whichever is the later.

(j) INTEREST.—Notwithstanding any other provision of this section, if any amount is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

(k) PAYMENTS IN DISCHARGE OF ALIMONY.—

(1) IN GENERAL.—This section shall not apply to so much of any payment under an annuity, endowment, or life insurance contract (or any interest therein) as is includible in the gross income of the wife under section 71 or section 682 (relating to income of an estate or trust in case of divorce, etc.).

(2) CROSS REFERENCE.—

For definition of "wife", see section 7701(a)(17).

(l) FACE-AMOUNT CERTIFICATES.—For purposes of this section, the term "endowment contract" includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a-2), issued after December 31, 1954.

(m) SPECIAL RULES APPLICABLE TO EMPLOYEE ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE PLANS.—

(1) CERTAIN AMOUNTS RECEIVED BEFORE ANNUITY STARTING DATE.—Any amounts received under an annuity, endowment, or life insurance contract before the annuity starting date which are not received as an annuity (within the meaning of subsection (e)(2)) shall be included in the recipient's gross income for the taxable year in which received to the extent that—

(A) such amounts, plus all amounts theretofore received under the contract and includible in gross income under this paragraph, do not exceed

(B) the aggregate premiums or other consideration paid for the contract while the employee was an owner-employee (as defined in section 401(c)(4)) which were allowed as deductions under section 404 for the taxable year and all prior taxable years (not including any portion of such premiums or other consideration properly allocable, as determined under regulations prescribed by the Secretary or his delegate, to the cost of life, accident, health, or other insurance).

Any such amounts so received which are not includible in gross income under this paragraph shall be subject to the provisions of subsection (e).

(2) COMPUTATION OF CONSIDERATION PAID BY THE EMPLOYEE.—In computing—

(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract),

(B) the consideration for the contract contributed by the employee for purposes of subsection (d)(1) (relating to employee's contributions recoverable in 3 years), and

(C) the aggregate premiums or other consideration paid for purposes of subsection (e)(1)(B) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the individual was a self-employed

individual within the meaning of section 401(c)(2) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the individual was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary or his delegate) to the cost of life, accident, health, or other insurance.

(3) LIFE INSURANCE CONTRACTS.—

(A) This paragraph shall apply to any life insurance contract—

(i) purchased as a part of a plan described in section 403(a), or

(ii) purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

(B) Any contributions to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404, and any income of a trust described in subparagraph (A)(ii), which is determined in accordance with regulations prescribed by the Secretary or his delegate to have been applied to purchase the life insurance protection under a contract described in subparagraph (A), is includible in the gross income of the participant for the taxable year when so applied.

(C) In the case of the death of an individual insured under a contract described in subparagraph (A), an amount equal to the cash surrender value of the contract immediately before the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101.

(4) AMOUNTS CONSTRUCTIVELY RECEIVED.—

(A) ASSIGNMENTS OR PLEDGES.—If during any taxable year an owner-employee assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a trust described in section 401(a) which is exempt from tax under section 501(a) or any portion of the value of a contract purchased as part of a plan described in section 403(a), such portion shall be treated as having been received by such owner-employee as a distribution from such trust or as an amount received under the contract.

(B) LOANS ON CONTRACTS.—If during any taxable year, an owner-employee receives, directly or indirectly, any amount from any insurance company as a loan under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as part of a plan described in section 403(a), and issued by such insurance company, such amount shall be treated as an amount received under the contract.

(5) *PENALTIES APPLICABLE TO CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.—*

(*A*) *This paragraph shall apply—*

(*i*) *to amounts (other than any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution) which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) and which are received by an individual, who is, or has been, an owner-employee, before such individual attains the age of 59½ years, for any reason other than the individual's becoming disabled (within the meaning of section 213(g)(3)), but only to the extent that such amounts are attributable to contributions paid on behalf of such individual (whether or not paid by him) while he was an owner-employee.*

(*ii*) *to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, an owner-employee, or by the successor of such individual, but only to the extent that such amounts are determined, under regulations prescribed by the Secretary or his delegate, to exceed the benefits provided for such individual under the plan formula, and*

(*iii*) *to amounts which are received, by reason of the distribution under the provisions of section 401(e)(2)(E), by an individual who is, or has been, an owner-employee of his entire interest in all qualified trusts described in section 401(a) and in all plans described in section 403(a).*

(*B*)(*i*) *If the aggregate of the amounts to which this paragraph applies received by any person in his taxable year equals or exceeds $2,500, the increase in his tax for the taxable year in which such amounts are received shall not be less than 110 percent of the aggregate increase in taxes, for the taxable year and the 4 immediately preceding taxable years, which would have resulted if such amounts had been included in such person's gross income ratably over such taxable years.*

(*ii*) *If deductions have been allowed under section 404 for contributions paid on behalf of the individual while he is an owner-employee for a number of prior taxable years less than 4, clause (i) shall be applied by taking into account a number of taxable years immediately preceding the taxable year in which the amount was so received equal to such lesser number.*

(*C*) *If subparagraph (B) does not apply to a person for the taxable year, the increase in tax of such person for the taxable year attributable to the amounts to which this paragraph applies shall be 110 percent of such increase (computed without regard to this subparagraph).*

(*D*) *Subparagraphs (A) (i) and (ii) of this paragraph shall not apply to any amount to which section 402(a)(2) or 403(a)(2) applies.*

(*E*) *For special rules for computation of taxable income for taxable years to which this paragraph applies, see subsection (n)(3).*

(6) Owner-employee defined.—For purposes of this subsection, the term "owner-employee" has the meaning assigned to it by section 401(c)(4).

(n) Treatment of Certain Distributions With Respect to Contributions by Self-Employed Individuals.—

(1) Application of subsection.—

(A) Distributions by employees' trust.—Subject to the provisions of subparagraph (C), this subsection shall apply to amounts distributed to a distributee, in the case of an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if the total distributions payable to the distributee with respect to an employee are paid to the distributee within one taxable year of the distributee—

(i) on account of the employee's death,

(ii) after the employee has attained the age of 59½ years, or

(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

(B) Annuity plans.—Subject to the provisions of subparagraph (C), this paragraph shall apply to amounts paid to a payee, in the case of an annuity plan described in section 403(a), if the total amounts payable to the payee with respect to an employee are paid to the payee within one taxable year of the payee—

(i) on account of the employee's death,

(ii) after the employee has attained the age of 59½ years, or

(iii) after the employee has become disabled (within the meaning of section 213(g)(3)).

(C) Limitations and exceptions.—This subsection shall apply—

(i) only with respect to so much of any distribution or payment to which (without regard to this subparagraph) subparagraph (A) or (B) applies as is attributable to contributions made by or for a self-employed individual within the meaning of section 401(c)(2), and

(ii) if the recipient is the individual by or for whom such contributions were made, only if contributions which were allowed as a deduction under section 404 have been made by or for such individual while he was a self-employed individual within the meaning of section 401(c)(2) for 5 or more taxable years prior to the taxable year in which the total distributions payable or total amounts payable, as the case may be, are paid.

This subsection shall not apply to amounts described in clauses (ii) and (iii) of subparagraph (A) of subsection (m)(5) (but, in the case of amounts described in clause (ii) of such subparagraph, only to the extent that subsection (m)(5) applies to such amounts).

(2) Limitation of tax.—In any case to which this subsection applies, the tax attributable to the amounts to which this subsection applies for the taxable year in which such amounts are received shall not be greater than 5 times the increase in tax which would result from the inclusion in gross income of the recipient of 20 percent of so much of the amount so received as is includible in gross income.

(3) DETERMINATION OF TAXABLE INCOME.—Notwithstanding section 63 (relating to definition of taxable income), for purposes only of computing the tax under this chapter attributable to amounts to which this subsection or subsection (m)(5) applies and which are includible in gross income, the taxable income of the recipient for the taxable year of receipt (and for any other taxable year involved in the computation under subsection (m)(5) shall be treated as being not less than the amount by which—

(A) the aggregate of such amounts so includible in gross income, exceeds

(B) the amount of the deductions allowed for such taxable year under section 151 (relating to deductions for personal exemptions).

In any case in which the preceding sentence results in an increase in taxable income for any taxable year, the resulting increase in the taxes imposed by section 1 or 3 for such taxable year shall not be reduced by any credit under part IV of subchapter A (other than section 31 thereof) which, but for this sentence, would be allowable.

[(m)] *(o)* CROSS REFERENCE.—

For limitation on adjustments to basis of annuity contracts sold, see section 1021.

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PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SEC. 101. CERTAIN DEATH BENEFITS.

(a) PROCEEDS OF LIFE INSURANCE CONTRACTS PAYABLE BY REASON OF DEATH.—

* * * * * * *

(b) EMPLOYEES' DEATH BENEFITS.—

(1) GENERAL RULE.—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) SPECIAL RULES FOR PARAGRAPH (1).—

(A) $5,000 LIMITATION.—The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000.

(B) NONFORFEITABLE RIGHTS.—Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to total distributions payable (as defined in section 402(a)(3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—

(i) by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a),

(ii) under an annuity contract under a plan [which meets the requirements of paragraphs (3), (4), (5), and (6) of section 401(a)] *described in section 403(a)*, or

(iii) under an annuity contract purchased by an employer which is an organization referred to in section 503(b) (1), (2), or (3) and which is exempt from tax under section 501(a), but only with respect to that portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract which are excludable from gross income under section 403(b) bear to the total amounts contributed by the employer for such annuity contract.

(C) JOINT AND SURVIVOR ANNUITIES.—Paragraph (1) shall not apply to amounts received by a surviving annuitant under a joint and survivor's annuity contract after the first day of the first period for which an amount was received as an annuity by the employee (or would have been received if the employee had lived).

(D) OTHER ANNUITIES.—In the case of any amount to which section 72 (relating to annuities, etc.) applies, the amount which is excludable under paragraph (1) (as modified by the preceding subparagraphs of this paragraph) shall be determined by reference to the value of such amount as of the day on which the employee died. Any amount so excludable under paragraph (1) shall, for purposes of section 72, be treated as additional consideration paid by the employee.

(3) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this subsection, an individual shall not be treated as an employee in the case of—

(A) a pension or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a), or

(B) an annuity contract under a plan described in section 403(a).

if such individual was included at any time under the plan as a self-employed individual within the meaning of section 401(c)(2).

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SEC. 104. COMPENSATION FOR INJURIES OR SICKNESS.

(a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic

Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22 U.S.C. 1081; 60 Stat. 1021).

For purposes of paragraph (3), in the case of an individual who is, or has been, a self-employed individual within the meaning of section 401(c)(2), contributions made by or for such individual while he was such an individual to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent attributable to contributions allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.

(b) CROSS REFERENCES.—

(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.

(2) For exclusion of part of disability retirement pay from the application of subsection (a)(4) of this section, see section 402(h) of the Career Compensation Act of 1949 (37 U.S.C. 272(h)).

SEC. 105. AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.

(a) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

(b) AMOUNTS EXPENDED FOR MEDICAL CARE.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213(e)) of the taxpayer, his spouse, and his dependents (as defined in section 152).

(c) PAYMENTS UNRELATED TO ABSENCE FROM WORK.—Gross income does not include amounts referred to in subsection (a) to the extent such amounts—

(1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement, of the taxpayer, his spouse, or a dependent (as defined in section 152), and

(2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

(d) WAGE CONTINUATION PLANS.—Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the

Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

(e) ACCIDENT AND HEALTH PLANS.—For purposes of this section and section 104—

(1) amounts received under an accident or health plan for employees, and

(2) amounts received from a sickness and disability fund for employees maintained under the law of a State, a Territory, or the District of Columbia,

shall be treated as amounts received through accident or health insurance.

(f) RULES FOR APPLICATION OF SECTION 213.—For purposes of section 213(a) (relating to medical, dental, etc., expenses) amounts excluded from gross income under subsection (c) or (d) shall not be considered as compensation (by insurance or otherwise) for expenses paid for medical care.

(g) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AS EMPLOYEE.—For purposes of this section, the term "employee" does not include an individual who is a self-employed individual within the meaning of section 401(c) (2).

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PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

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SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) DEDUCTION ALLOWED.— * * *

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(d) MODIFICATIONS.—The modifications referred to in this section are as follows:

(1) NET OPERATING LOSS DEDUCTION.—No net operating loss deduction shall be allowed.

(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation—

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets; and

(B) the deduction for long-term capital gains provided by section 1202 shall not be allowed.

(3) DEDUCTION FOR PERSONAL EXEMPTIONS.—No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) NONBUSINESS DEDUCTIONS OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) any gain or loss from the sale or other disposition of—
(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or
(ii) real property used in the trade or business,
shall be treated as attributable to the trade or business;
(B) the modifications specified in paragraphs (1), (2)(B), and (3) shall be taken into account; [and]
(C) any deduction allowable under section 165(c)(3) (relating to casualty losses) shall not be taken into account[.]; *and*
(D) any deduction allowed under section 404 or section 405(c) to the extent attributable to contributions which are made on behalf of an individual who is a self-employed individual within the meaning of section 401(c)(2) shall not be treated as attributable to the trade or business of such individual.

(5) SPECIAL DEDUCTIONS FOR CORPORATIONS.—No deduction shall be allowed under section 242 (relating to partially tax exempt interest) or under section 922 (relating to Western Hemisphere trade corporations).

(6) COMPUTATION OF DEDUCTION FOR DIVIDENDS RECEIVED, ETC.—The deductions allowed by sections 243 (relating to dividend's received by corporations), 244 (relating to dividends received on certain preferred stock of public utilities), and 245 relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions); and the deduction allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities) shall be computed without regard to subsection (a)(1)(B) of such section.

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Subchapter D—Deferred Compensation, Etc.

Part I. Pension, profit-sharing, stock bonus plans, etc.
Part II. Miscellaneous provisions.

PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

Sec. 401. Qualified pension, profit-sharing, and stock bonus plans.
Sec. 402. Taxability of beneficiary of employees' trust.
Sec. 403. Taxation of employee annuities.
Sec. 404. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan.
Sec. 405. Qualified bond purchase plans.

SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries;

(3) if the trust, or two or more trusts, or the trust or trusts and annuity plan or plans are designated by the employer as constituting parts of a plan intended to qualify under this subsection which benefits either—

(A) 70 percent or more of all the employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have been employed not more than a minimum period prescribed by the plan, not exceeding 5 years, employees whose customary employment is for not more than 20 hours in any one week, and employees whose customary employment is for not more than 5 months in any calendar year, or

(B) such employees as qualify under a classification set up by the employer and found by the Secretary or his delegate not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees;

and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

(5) A classification shall not be considered discriminatory within the meaning of paragraph (3)(B) or (4) merely because it excludes employees the whole of whose remuneration constitutes "wages" under section 3121(a)(1) (relating to the Federal Insurance Contributions Act) or merely because it is limited to salaried or clerical employees. Neither shall a plan be considered discriminatory within the meaning of such provisions merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of such employees, or merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 3121(a)(1) differ from the contributions or benefits based on employee's remuneration not so excluded, or differ because of any retirement benefits created under State or Federal law. *For purposes of this paragraph and subsection (d)(5), the total compensation of an individual who is a*

self-employed individual (as defined in subsection (c)(2)) is such individual's self-employment earnings (as defined in subsection (c)(3)) and the basic or regular rate of compensation of such an individual shall be determined, under regulations prescribed by the Secretary or his delegate, with respect to that portion of his self-employment earnings which bears the same ratio to his self-employment earnings as the basic or regular compensation of the employees (other than self-employed individuals) under the plan bears to the total compensation of such employees.

(6) A plan shall be considered as meeting the requirements of paragraph (3) during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, upon its termination or upon complete discontinuance of contributions under the plan, the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent then funded, or the amounts credited to the employees' accounts, are nonforfeitable. This paragraph shall not apply to benefits or contributions which, under provisions of the plan adopted pursuant to regulations prescribed by the Secretary or his delegate to preclude the discrimination prohibited by paragraph (4), may not be used for designated employees in the event of early termination of the plan.

(8) A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the entire interest of each employee—

(A) either will be distributed to him not later than his taxable year in which he attains the age of 70½ years, or, in the case of an employee other than an owner-employee (as defined in subsection (c)(4)), in which he retires, whichever is the later, or

(B) will be distributed, commencing not later than such taxable year, (i) in accordance with regulations prescribed by the Secretary or his delegate, over the life of such employee or over the lives of such employee and his spouse, or (ii) in accordance with such regulations, over the life expectancy of such employee or over the life expectancy of such employee and his spouse.

(9) A trust forming part of a pension plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(10) If—

(A)(i) on one day in each quarter in the taxable year of the plan, an employer has more than 3 employees, or

(ii) this paragraph applied at any prior time in respect of such plan, and

(B) the plan provides for current or future contributions for any owner-employee,

then the trust shall be a qualified trust under this section only if each employee having a period of employment of 3 years or more is included under the plan. For purposes of the preceding sentence, (i) the term "employee" does not include any employee whose customary employment is for not more than 20 hours in any one week or is for not more than 5 months in any calendar year, nor does such term include an owner-employee, and (ii) in the case of a partner who is not an

owner-employee, the period of time during which he has been such a partner shall be included in his period of employment.

(11) If paragraph (10) does not apply, then the determination as to whether a trust is a qualified trust under this subsection shall be made—

(A) in the case of a plan which provides contributions or benefits for employees who are not owner-employees, without reference to any portion of such plan which provides contributions or benefits for owner-employees, and

(B) in the case of a plan which provides contributions or benefits for owner-employees, without reference to any portion of such plan which provides contributions or benefits for employees who are not owner-employees.

(12) A trust forming part of a plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(4)) shall constitute a qualified trust under this section only if the requirements in subsection (d) are also met.

(b) CERTAIN RETROACTIVE CHANGES IN PLAN.—A stock bonus, pension, profit-sharing, or annuity plan shall be considered as satisfying the requirements of paragraphs (3), (4), (5), and (6) of subsection (a) for the period beginning with the date on which it was put into effect and ending with the 15th day of the third month following the close of the taxable year of the employer in which the plan was put in effect, if all provisions of the plan which are necessary to satisfy such requirements are in effect by the end of such period and have been made effective for all purposes with respect to the whole of such period.

(c) DEFINITIONS AND RULES RELATING TO SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—For purposes of this section—

(1) EMPLOYEE.—The term "employee" includes, for any taxable year, a self-employed individual.

(2) SELF-EMPLOYED INDIVIDUAL.—The term "self-employed individual" means an individual who has self-employment earnings (as defined in paragraph (3)) for the taxable year.

(3) SELF-EMPLOYMENT EARNINGS.—The term "self-employment earnings" means net earnings from self-employment (as defined in section 1402(a)) determined—

(A) without regard to paragraphs (4) and (5) of section 1402(c),

(B) in the case of any individual who is treated as an employee under section 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

(C) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

(4) OWNER-EMPLOYEE.—The term "owner-employee" means a self-employed individual who—

(A) derives self-employment earnings from a trade or business carried on by him, or

(B) in the case of a partnership, is a partner who owns more than 10 percent of either the capital interest or the profits interest in such partnership.

(5) EMPLOYER.—In the case of a trade or business carried on by a self-employed individual, such individual shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (1).

(d) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

(1) In the case of a trust which is created on or after the date of the enactment of this subsection, or which was created before such date but is not exempt from tax under section 501(a) as an organization described in subsection (a) on the day before such date, the trustee is a bank, but a person (including the employer) other than a bank may be granted, under the trust instrument, the power to control the investment of the trust funds either by directing investments (including reinvestments, disposals, and exchanges) or by disapproving proposed investments (including reinvestments, disposals, and exchanges). This paragraph shall not apply to a trust created or organized outside the United States before the date of the enactment of this subsection if, under section 402(c), it is treated as exempt from taxation under section 501(a) on the day before such date. For purposes of this paragraph, the term "bank" means—

(A) a bank as defined in section 581,

(B) a corporation which under the laws of the State of its incorporation is subject to supervision and examination by the commissioner of banking or other officer of such State in charge of the administration of the banking laws of such State, and

(C) in the case of a trust created or organized outside the United States, a bank or trust company, wherever incorporated, exercising fiduciary powers and subject to supervision and examination by governmental authority.

(2) Under the plan, no benefits may be paid to any owner-employee before he attains the age of 59½ years, except in the case of his becoming disabled (within the meaning of section 213(g)(3)).

(3) If subsection (a)(10) applies, the employees' rights to or derived from the contributions under the plan are nonforfeitable at the time the contributions are paid to or under the plan.

(4) In the case of a profit-sharing plan, the plan provides a definite formula for determining the contributions to be made to the trust by the employer on behalf of employees (other than owner-employees).

(5) If subsection (a)(10) applies, the plan does not permit the ratio of contributions by the employer for any owner-employee to such owner-employee's compensation to exceed the ratio of contributions by the employer for any employee (other than an owner-employee) to his compensation. For purposes of this paragraph—

(A) The term "compensation" means total compensation, or basic or regular rate of compensation, whichever may be specified in the plan.

(B) If—

(i) of the contributions deductible under section 404, not more than one-third is deductible by reason of contributions by the employer for owner-employees, and

(ii) taxes paid by the owner-employee under chapter 2 (relating to tax on self-employment income), and the taxes which would be payable under such chapter 2 by the owner-employee but for paragraphs (4) and (5) of section 1402(c), are taken into account as contributions by the employer for such owner-employee,

then taxes paid under section 3111 (relating to tax on employers) with respect to an employee may be taken into account as contributions by the employer for such employee under the plan.

(6) The plan does not permit—

(A) contributions to be made by the employer for any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year;

(B) in the case of a plan (or, if subsection (a)(11) applies, the portion thereof) which provides contributions or benefits only for owner-employees, contributions by or for any owner-employee in excess of the amounts which may be deducted under section 404 for the taxable year; and

(C) if a distribution under the plan is made to any employee and if any portion of such distribution is an amount described in section 72(m)(5)(A)(i) (whether or not section 72(m)(5) applies to such amount), contributions to be made on behalf of such employee for the 5 taxable years succeeding the taxable year in which such distribution is made.

(7) Under the plan, if an owner-employee dies before his entire interest has been distributed to him, or if distribution has been commenced in accordance with subsection (a)(8)(B) to his surviving spouse and such surviving spouse dies before his entire interest has been distributed to her, his entire interest (or the remaining part of such interest if distribution thereof has commenced) will, within 5 years after his death (or the death of his surviving spouse), be distributed, or applied to the purchase of an immediate annuity for his beneficiary or beneficiaries (or the beneficiary or beneficiaries of his surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which will be immediately distributed to such beneficiary or beneficiaries.

(8) Under the plan—

(A) any contribution which is an excess contribution (as defined in subsection (e)(1)), together with the income attributable to such excess contribution, is (unless subsection (e)(2)(E) applies) to be repaid to the owner-employee by or for whom such excess contribution is made;

(B) if for any taxable year the plan does not, by reason of subsection (e)(2)(A), meet (for purposes of section 404) the requirements of this subsection with respect to an owner-employee, the income for the taxable year attributable to the interest of such owner-employee under the plan is to be paid to such owner-employee; and

(C) the entire interest of an owner-employee is to be repaid to him when required by the provisions of subsection (e)(2)(E).

(9)(A) If the plan provides contributions or benefits for an owner-employee who controls, or for two or more owner-employees who together control, the trade or business with respect to which the

plan is established, and who also control as an owner-employee or as owner-employees one or more other trades or businesses, such plan and the plans (if any) established with respect to such other trades or businesses constitute a plan which meets the requirements of paragraphs (3) and (4), and paragraph (10) or (11) (as the case may be), of subsection (a) with respect to the employees of all such trades or businesses (including the trade or business with respect to which the plan intended to qualify under this section is established).

(B) For purposes of subparagraph (A), an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

(i) own the entire interest in an unincorporated trade or business, or

(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of the preceding sentence, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-employee, or such two or more owner-employees, are considered to control within the meaning of the preceding sentence.

(10) Under the plan, contributions by or for any owner-employee may be made only with respect to the self-employment earnings of such owner-employee derived from the trade or business with respect to which such plan is established.

(e) EXCESS CONTRIBUTIONS ON BEHALF OF OWNER-EMPLOYEES.—

(1) EXCESS CONTRIBUTION DEFINED.—For purposes of this section, the term "excess contribution" means—

(A) if, in the taxable year, contributions are made under the plan (or, if subsection (a)(11) applies, under the portion of the plan) only by or for owner-employees, the amount of any contribution made by or for any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year; or

(B) if subparagraph (A) does not apply—

(i) the amount of any contribution made by the employer for any owner-employee which (without regard to this subsection) is not deductible under section 404 for the taxable year;

(ii) the amount of any contribution made by any owner-employee (as an employee) at a rate which exceeds the rate of contributions permitted to be made by employees other than owner-employees; and

(iii) the amount of any contribution made under the plan by any owner-employee (as an employee) which exceeds the lesser of $2,500 or 10 percent of the self-employment earnings for such taxable year derived by such owner-employee from the trade or business (or trades and businesses) with respect to which the plan is established; and

(C) the amount of any contribution made by or for an owner-employee in any taxable year for which, under paragraph (2)(A) or (E), the plan does not (for purposes of section

404) meet the requirements of subsection (d) with respect to such owner-employee.

For purposes of this subsection, the amount of any contribution which is allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

(2) EFFECT OF EXCESS CONTRIBUTION.—

(A) IN GENERAL.—If an excess contribution (other than an excess contribution to which subparagraph (E) applies) is made by or for an owner-employee in any taxable year, the plan with respect to which such excess contribution is made shall, except as provided in subparagraphs (C) and (D), be considered, for purposes of section 404, as not meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year and for all succeeding taxable years.

(B) INCLUSION OF AMOUNTS IN GROSS INCOME OF OWNER-EMPLOYEES.—For any taxable year for which any plan does not meet the requirements of subsection (d) with respect to an owner-employee by reason of subparagraph (A), the gross income of such owner-employee shall, for purposes of this chapter, include the amount of income for such taxable year attributable to the interest of such owner-employee under such plan.

(C) REPAYMENT WITHIN PRESCRIBED PERIOD.—Subparagraph (A) shall not apply to an excess contribution with respect to any taxable year, if, on or before the close of the 6-month period beginning on the day on which the Secretary or his delegate sends notice (by certified or registered mail) to the person to whom such excess contribution was paid of the amount of such excess contribution, the amount of such excess contribution, and the income attributable thereto, is repaid to the owner-employee by or for whom such excess contribution was made. If the excess contribution is an excess contribution as defined in paragraph (1) (A) or (B)(i), or is an excess contribution as defined in paragraph (1)(C) with respect to which a deduction has been claimed under section 404, the notice required by the preceding sentence shall not be mailed prior to the time that the amount of the tax under this chapter of such owner-employee for the taxable year in which such excess contribution was made has been finally determined.

(D) REPAYMENT AFTER PRESCRIBED PERIOD.—If an excess contribution, together with the income attributable thereto, is not repaid within the 6-month period referred to in subparagraph (C), subparagraph (A) shall not apply to an excess contribution with respect to any taxable year beginning with the taxable year in which the person to whom such excess contribution was paid repays the amount of such excess contribution to the owner-employee by or for whom such excess contribution was made, and pays to such owner-employee the amount of income attributable to the interest of such owner-employee which, under subparagraph (B), has been included in the gross income of such owner-employee for any prior taxable year.

(E) SPECIAL RULE IF EXCESS CONTRIBUTION WAS WILLFULLY MADE.—If an excess contribution made by or for an

owner-employee is determined to have been willfully made, then—

(i) subparagraphs (A), (B), (C), and (D) shall not apply with respect to such excess contribution;

(ii) there shall be distributed to the owner-employee by or for whom such excess contribution was willfully made his entire interest in all plans with respect to which he is an owner-employee; and

(iii) no plan shall, for purposes of section 404, be considered as meeting the requirements of subsection (d) with respect to such owner-employee for the taxable year in which it is determined that such excess contribution was willfully made and for the 5 taxable years following such taxable year.

(F) STATUTE OF LIMITATIONS.—In any case in which subparagraph (A) applies, the period for assessing any deficiency arising by reason of—

(i) the disallowance of any deduction under section 404 on account of a plan not meeting the requirements of subsection (d) with respect to the owner-employee by or for whom an excess contribution was made, or

(ii) the inclusion, under subparagraph (B), in gross income of such owner-employee of income attributable to the interest of such owner-employee under a plan,

for the taxable year in which such excess contribution was made or for any succeeding taxable year shall not expire prior to one year after the close of the 6-month period referred to in subparagraph (C).

(f) CERTAIN CUSTODIAL ACCOUNTS.—

(1) TREATMENT AS QUALIFIED TRUST.—For purposes of this title, a custodial account shall be treated as a qualified trust under this section, if—

(A) such custodial account would, except for the fact that it is not a trust, constitute a qualified trust under this section;

(B) the custodian is a bank (as defined in section 581);

(C) the investment of the contributions to such account, and of the earnings attributable thereto, is to be made solely in regulated investment company stock with respect to which an employee is the beneficial owner; and

(D) the shareholder of record of any such stock is the custodian or its nominee.

(2) DEFINITION.—For purposes of paragraph (1), the term "regulated investment company" means a domestic corporation which—

(A) is a regulated investment company within the meaning of section 851(a), and

(B) issues only redeemable stock.

(g) FACE-AMOUNT CERTIFICATES TREATED AS ANNUITIES.—For purposes of this section and sections 402, 403, and 404, the term "annuity" includes a face-amount certificate, as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C., sec. 80a–2).

[(c)] (*h*) CROSS REFERENCE.—

For exemption from tax of a trust qualified under this section, see section 501(a).

SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

(a) TAXABILITY OF BENEFICIARY OF EXEMPT TRUST.—

(1) GENERAL RULE.—Except as provided in paragraphs (2) and (4), the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities) except that section 72(e) (3) shall not apply. The amount actually distributed or made available to any distributee shall not include net unrealized appreciation in securities of the employer corporation attributable to the amount contributed by the employee. Such net unrealized appreciation and the resulting adjustments to basis of such securities shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(2) CAPITAL GAINS TREATMENT FOR CERTAIN DISTRIBUTIONS.— In the case of an employees' trust described in section 401(a), which is exempt from tax under section 501(a), if the total distributions payable with respect to any employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after his separation from the service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not includible in gross income, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months. Where such total distributions include securities of the employer corporation, there shall be excluded from such excess the net unrealized appreciation attributable to that part of the total distributions which consists of the securities of the employer corporation so distributed. The amount of such net unrealized appreciation and the resulting adjustments to basis of the securities of the employer corporation so distributed shall be determined in accordance with regulations prescribed by the Secretary or his delegate. *This paragraph shall not apply to distributions paid to any distributee to the extent such distributions are attributable to contributions made by or for an individual while he was a self-employed individual within the meaning of section 401(c)(2).*

(3) DEFINITIONS.—For purposes of this subsection—

(A) The term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form.

(B) The term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in section 421(d) (2) and (3)) of the employer corporation.

(C) The term "total distributions payable" means the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death or other

separation from the service, or on account of his death after separation from the service.

(4) DISTRIBUTIONS BY UNITED STATES TO NONRESIDENT ALIENS.—The amount includible under paragraph (1) or (2) of this subsection in the gross income of a nonresident alien individual with respect to a distribution made by the United States in respect of services performed by an employee of the United States shall not exceed an amount which bears the same ratio to the amount includible in gross income without regard to this paragraph as—

(A) the aggregate basic salary paid by the United States to such employee for such services, reduced by the amount of such basic salary which was not includible in gross income by reason of being from sources without the United States, bears to

(B) the aggregate basic salary paid by the United States to such employee for such services.

In the case of distributions under the Civil Service Retirement Act (5 U.S.C. 2251), the term "basic salary" shall have the meaning provided in section 1(d) of such Act.

(b) TAXABILITY OF BENEFICIARY OF NON-EXEMPT TRUST.—Contributions to an employees' trust made by an employer during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt from tax under section 501(a) shall be included in the gross income of an employee for the taxable year in which the contribution is made to the trust in the case of an employee whose beneficial interest in such contribution is nonforfeitable at the time the contribution is made. The amount actually distributed or made available to any distributee by any such trust shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(c) TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.—For purposes of subsections (a) and (b), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).

(d) CERTAIN EMPLOYEES' ANNUITIES.—Notwithstanding subsection (b) or any other provision of this subtitle, a contribution to a trust by an employer shall not be included in the gross income of the employee in the year in which the contribution is made if—

(1) such contribution is to be applied by the trustee for the purchase of annuity contracts for the benefit of such employee;

(2) such contribution is made to the trustee pursuant to a written agreement entered into prior to October 21, 1942, between the employer and the trustee, or between the employer and the employee; and

(3) under the terms of the trust agreement the employee is not entitled during his lifetime, except with the consent of the trustee, to any payments under annuity contracts purchased by the trustee other than annuity payments.

The employee shall include in his gross income the amounts received under such contracts for the year received as provided in section 72

(relating to annuities) except that section 72(e)(3) shall not apply. This subsection shall have no application with respect to amounts contributed to a trust after June 1, 1949, if the trust on such date was exempt under section 165(a) of the Internal Revenue Code of 1939. For purposes of this subsection, amounts paid by an employer for the purchase of annuity contracts which are transferred to the trustee shall be deemed to be contributions made to a trust or trustee and contributions applied by the trustee for the purchase of annuity contracts; the term "annuity contracts purchased by the trustee" shall include annuity contracts so purchased by the employer and transferred to the trustee; and the term "employee" shall include only a person who was in the employ of the employer, and was covered by the agreement referred to in paragraph (2), prior to October 21, 1942.

(e) CERTAIN PLAN TERMINATIONS.—For purposes of subsection (a)(2), distributions made after December 31, 1953, and before January 1, 1955, as a result of the complete termination of a stock bonus, pension, or profit-sharing plan of an employer which is a corporation, if the termination of the plan is incident to the complete liquidation, occurring before the date of enactment of this title, of the corporation, whether or not such liquidation is incident to a reorganization as defined in section 368(a), shall be considered to be distributions on account of separation from service.

SEC. 403. TAXATION OF EMPLOYEE ANNUITIES.

(a) TAXABILITY OF BENEFICIARY UNDER A QUALIFIED ANNUITY PLAN.—

(1) GENERAL RULE.—Except as provided in paragraph (2), if an annuity contract is purchased by an employer for an employee under a plan which meets the requirements of section 404(a)(2) (whether or not the employer deducts the amounts paid for the contract under such section), the employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(2) CAPITAL GAINS TREATMENT FOR CERTAIN DISTRIBUTIONS.—

(A) GENERAL RULE.—If—

(i) an annuity contract is purchased by an employer for an employee under a plan [which meets the requirements of section 401(a) (3), (4), (5), and (6)] *described in paragraph (1)*;

(ii) such plan requires that refunds of contributions with respect to annuity contracts purchased under such plan be used to reduce subsequent premiums on the contracts under the plan; and

(iii) the total amounts payable by reason of an employee's death or other separation from the service, or by reason of the death of an employee after the employee's separation from the service, are paid to the payee within one taxable year of the payee,

then the amount of such payments, to the extent exceeding the amount contributed by the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore paid to him which were not includible in gross income, shall be considered a gain from the sale or exchange of a capital asset held for more

than 6 months. *This subparagraph shall not apply to amounts paid to any payee to the extent such amounts are attributable to contributions made by or for an individual while he was a self-employed individual within the meaning of section 401(c)(2).*

(B) DEFINITION.—For purposes of subparagraph (A), the term "total amounts" means the balance to the credit of an employee which becomes payable to the payee by reason of the employee's death or other separation from the service, or by reason of his death after separation from the service.

(3) SELF-EMPLOYED INDIVIDUALS.—For purposes of this subsection, the term "employee" includes an individual who is a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual is the person treated as his employer under section 401(c)(5).

(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION.—

(1) GENERAL RULE.—If—

(A) an annuity contract is purchased for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

(B) such annuity contract is not subject to subsection (a), and

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(2) EXCLUSION ALLOWANCE.—For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of—

(A) the amount determined by multiplying (i) 20 percent of his includible compensation, by (ii) the number of years of service, over

(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

(3) INCLUDIBLE COMPENSATION.—For purposes of this subsection, the term "includible compensation" means, in the case of any employee, the amount of compensation which is received from the employer described in section 501(c)(3) and exempt from tax under section 501(a), and which is includible in gross income (computed without regard to sections 105(d) and 911) for the most recent period (ending not later than the close of the taxable year) which under paragraph (4) may be counted as one year of service. Such term does not include any amount contributed by the employer for any annuity contract to which this subsection applies.

(4) YEARS OF SERVICE.—In determining the number of years of service for purposes of this subsection, there shall be included—

(A) one year for each full year during which the individual was a full-time employee of the organization purchasing the annuity for him, and

(B) a fraction of a year (determined in accordance with regulations prescribed by the Secretary or his delegate) for each full year during which such individual was a part-time employee of such organization and for each part of a year during which such individual was a full-time or part-time employee of such organization.

In no case shall the number of years of service be less than one.

(5) APPLICATION TO MORE THAN ONE ANNUITY CONTRACT.—If for any taxable year of the employee this subsection applies to 2 or more annuity contracts purchased by the employer, such contracts shall be treated as one contract.

(6) FORFEITABLE RIGHTS WHICH BECOME NONFORFEITABLE.—For purposes of this subsection and section 72(f) (relating to special rules for computing employees' contributions to annuity contracts), if rights of the employee under an annuity contract described in subparagraphs (A) and (B) of paragraph (1) change from forfeitable to nonforfeitable rights, then the amount (determined without regard to this subsection) includible in gross income by reason of such change shall be treated as an amount contributed by the employer for such annuity contract as of the time such rights become nonforfeitable.

(c) TAXABILITY OF BENEFICIARY UNDER A NONQUALIFIED ANNUITY.—If an annuity contract purchased by an employer for an employee is not subject to subsection (a) and the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums, the amount contributed by the employer for such annuity contract on or after such rights become nonforfeitable shall be included in the gross income of the employee in the year in which the amount is contributed. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(d) TAXABILITY OF BENEFICIARY UNDER CERTAIN FORFEITABLE CONTRACTS PURCHASED BY EXEMPT ORGANIZATIONS.—Notwithstanding the first sentence of subsection (c), if rights of an employee under an annuity contract purchased by an employer which is exempt from tax under section 501(a) or 521(a) change from forfeitable to nonforfeitable rights, the value of such contract on the date of such change (to the extent attributable to amounts contributed by the employer after December 31, 1957) shall, except as provided in subsection (b), be included in the gross income of the employee in the year of such change.

SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.

(a) GENERAL RULE.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for

the production of income); but, if they satisfy the conditions of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

(1) PENSION TRUSTS.—In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 501(a), in an amount determined as follows:

(A) an amount not in excess of 5 percent of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the Secretary or his delegate upon periodical examinations at not less than 5-year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(B) any excess over the amount allowable under subparagraph (A) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Secretary or his delegate, but if such remaining unfunded cost with respect to any 3 individuals is more than 50 percent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

(C) in lieu of the amounts allowable under subparagraphs (A) and (B) above, an amount equal to the normal cost of the plan, as determined, under regulations prescribed by the Secretary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 percent of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Secretary or his delegate, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased.

(D) Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

(2) EMPLOYEES' ANNUITIES.—In the taxable year when paid, in an amount determined in accordance with paragraph (1), if the contributions are paid toward the purchase of retirement annuities and such purchase is a part of a plan which meets the requirements of [section 401(a) (3), (4), (5), and (6),] *section*

401(a) (other than paragraphs (1), (2), and (12)) and, in the case of a plan described in paragraph (9) of this subsection, which meets the requirements of section 401(d) (other than paragraphs (1), (3), and (4)) and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year towards the purchase of such retirement annuities.

(3) STOCK BONUS AND PROFIT-SHARING TRUSTS.—

(A) LIMITS ON DEDUCTIBLE CONTRIBUTIONS.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to all employees under the stock bonus or profit-sharing plan. If in any taxable year there is paid into the trust, or a similar trust then in effect, amounts less than the amounts deductible under the preceding sentence, the excess, or if no amount is paid, the amounts deductible, shall be carried forward and be deductible when paid in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any such succeeding taxable year shall not exceed 15 percent of the compensation otherwise paid or accrued during such succeeding taxable year to the beneficiaries under the plan. In addition, any amount paid into the trust in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this subparagraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this subparagraph shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan. The term "stock bonus or profit-sharing trust", as used in this subparagraph, shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in paragraph (1). If the contributions are made to 2 or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for purposes of applying the limitations in this subparagraph.

(B) PROFIT-SHARING PLAN OF AFFILIATED GROUP.—In the case of a profit-sharing plan, or a stock bonus plan in which contributions are determined with reference to profits, of a group of corporations which is an affiliated group within the meaning of section 1504, if any member of such affiliated group is prevented from making a contribution which it would otherwise have made under the plan, by reason of having no current or accumulated earnings or profits or because such earnings or profits are less than the contributions which it would otherwise have made, then so much of the contribution which such member was so pre-

vented from making may be made, for the benefit of the employees of such member, by the other members of the group, to the extent of current or accumulated earnings or profits, except that such contribution by each such other member shall be limited, where the group does not file a consolidated return, to that proportion of its total current and accumulated earnings or profits remaining after adjustment for its contribution deductible without regard to this subparagraph which the total prevented contribution bears to the total current and accumulated earnings or profits of all the members of the group remaining after adjustment for all contributions deductible without regard to this subparagraph. Contributions made under the preceding sentence shall be deductible under subparagraph (A) of this paragraph by the employer making such contribution, and, for the purpose of determining amounts which may be carried forward and deducted under the second sentence of subparagraph (A) of this paragraph in succeeding taxable years, shall be deemed to have been made by the employer on behalf of whose employees such contributions were made.

(4) TRUSTS CREATED OR ORGANIZED OUTISDE THE UNITED STATES.—If a stock bonus, pension, or profit-sharing trust would qualify for exemption under section 501(a) except for the fact that it is a trust created or organized outside the United States, contributions to such a trust by an employer which is a resident, or corporation, or other entity of the United States, shall be deductible under the preceding paragraphs.

(5) OTHER PLANS.—In the taxable year when paid, if the plan is not one included in paragraph (1), (2), or (3), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

(6) TAXPAYERS ON ACCRUAL BASIS.—For purposes of paragraphs (1), (2), and (3), a taxpayer on the accrual basis shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

(7) LIMIT OF DEDUCTION.—If amounts are deductible under paragraphs (1) and (3), or (2) and (3), or (1), (2), and (3), in connection with 2 or more trusts, or one or more trusts and an annuity plan, the total amount deductible in a taxable year under such trusts and plans shall not exceed 25 percent of the compensation otherwise paid or accrued during the taxable year to the persons who are the beneficiaries of the trusts or plans. In addition, any amount paid into such trust or under such annuity plans in any taxable year in excess of the amount allowable with respect to such year under the preceding provisions of this paragraph shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this sentence in any one such succeeding taxable year together with the amount allowable under the first sentence of this paragraph shall not exceed 30 percent of the compensation otherwise paid or accrued during such taxable years to the beneficiaries under the

trusts or plans. This paragraph shall not have the effect of reducing the amount otherwise deductible under paragraphs (1), (2), and (3), if no employee is a beneficiary under more than one trust, or a trust and an annuity plan.

(8) SELF-EMPLOYED INDIVIDUALS.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for self-employed individuals within the meaning of section 401(c)(2), for purposes of this section—

(A) the term "employee" includes a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual is the person treated as his employer under section 401(c)(5);

(B) the term "self-employment earnings" has the meaning assigned to it by section 401(c)(3);

(C) the contributions to such plan by or for a self-employed individual shall be considered to satisfy the conditions of section 162 or 212 to the extent that such contributions do not exceed the self-employment earnings of such individual derived from the trade or business with respect to which such plan is established, and to the extent that such contributions are not allocable (determined in accordance with regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance; and

(D) any reference to compensation shall, in the case of a self-employed individual, be considered to be a reference to the self-employment earnings of such individual derived from the trade or business with respect to which the plan is established.

(9) PLANS BENEFITING OWNER-EMPLOYEES.—In the case of a plan included in paragraph (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are owner-employees—

(A) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of employees (other than owner-employees), as if such employees were the only employees for whom contributions and benefits are provided under the plan;

(B) the limitations provided by paragraphs (1), (2), (3), and (7) on the amounts deductible for any taxable year shall be computed, with respect to contributions on behalf of owner-employees—

(i) as if such owner-employees were the only employees for whom contributions and benefits are provided under the plan, and

(ii) without regard to paragraph (1)(D), the second and third sentences of paragraph (3), and the second sentence of paragraph (7); and

(C) the amounts deductible under paragraphs (1), (2), (3), and (7), with respect to contributions on behalf of any owner-employee, shall not exceed the applicable limitation provided in subsection (e).

For purposes of this paragraph and subsections (e) and (f), the term "owner-employee" has the meaning assigned to it by section 401(c)(4).

(b) METHOD OF CONTRIBUTIONS, ETC., HAVING THE EFFECT OF A PLAN.—If there is no plan but a method of employer contributions or compensation has the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, subsection (a) shall apply as if there were such a plan.

(c) CERTAIN NEGOTIATED PLANS.—If contributions are paid by an employer—

(1) under a plan under which such contributions are held in trust for the purpose of paying (either from principal or income or both) for the benefit of employees and their families and dependents at least medical or hospital care, and pensions on retirement or death of employees; and

(2) such plan was established prior to January 1, 1954, as a result of an agreement between employee representatives and the Government of the United States during a period of Government operation, under seizure powers, of a major part of the productive facilities of the industry in which such employer is engaged,

such contributions shall not be deductible under this section nor be made nondeductible by this section, but the deductibility thereof shall be governed solely by section 162 (relating to trade or business expenses). This subsection shall have no application with respect to amounts contributed to a trust on or after any date on which such trust is qualified for exemption from tax under section 501(a).

(d) CARRYOVER OF UNUSED DEDUCTIONS.—The amount of any unused deductions or contributions in excess of the deductible amounts for taxable years to which this part does not apply which under section 23(p) of the Internal Revenue Code of 1939 would be allowable as deductions in later years had such section 23(p) remained in effect, shall be allowable as deductions in taxable years to which this part applies as if such section 23(p) were continued in effect for such years. However, the deduction under the preceding sentence shall not exceed an amount which, when added to the deduction allowable under subsection (a) for contributions made in taxable years to which this part applies, is not greater than the amount which would be deductible under subsection (a) if the contributions which give rise to the deduction under the preceding sentence were made in a taxable year to which this part applies.

(e) SPECIAL LIMITATIONS FOR OWNER-EMPLOYEES.—

(1) IN GENERAL.—In the case of a plan included in subsection (a) (1), (2), or (3) which provides contributions or benefits for employees some or all of whom are owner-employees, the amounts deductible under subsection (a) in any taxable year with respect to contributions on behalf of any owner-employee shall not exceed whichever of the following amounts is the greater:

(A) $2,500, or 10 percent of the self-employment earnings derived by such owner-employee from the trade or business with respect to which the plan is established, whichever is the lesser; or

(B) if section 401(a)(10) applies, the maximum amount of contributions permitted on behalf of such owner-employee on the application of section 401(d)(5).

(2) CONTRIBUTIONS MADE UNDER MORE THAN ONE PLAN.—

(A) OVERALL LIMITATION.—In any taxable year in which amounts are deductible with respect to two or more plans (whether established with respect to the same trade or business

or different trades or businesses) on behalf of an individual who is an owner-employee with respect to such plans, the aggregate amount deductible for such taxable year under such plans with respect to contributions on behalf of such owner-employee shall not exceed whichever of the following amounts is the greater:

(i) $2,500, or

(ii) the sum of the amounts so contributed under all such plans to the extent that, with respect to each such plan, the amount contributed does not exceed the amount described in paragraph (1)(B).

(B) ALLOCATION OF AMOUNTS DEDUCTIBLE.—In any case in which the amounts deductible under subsection (a) (with the application of the limitations of this subsection) with respect to contributions made by or for an owner-employee under two or more plans are, by reason of subparagraph (A), less than the amounts deductible under such subsection determined without regard to such subparagraph, the amount deductible under subsection (a) with respect to such contributions under each such plan shall be determined in accordance with regulations prescribed by the Secretary or his delegate.

(3) CONTRIBUTIONS ALLOCABLE TO INSURANCE PROTECTION.—For purposes of this subsection, contributions which are allocable (determined under regulations prescribed by the Secretary or his delegate) to the purchase of life, accident, health, or other insurance shall not be taken into account.

(f) CERTAIN LOAN REPAYMENTS CONSIDERED AS CONTRIBUTIONS.—For purposes of this section, any amount paid, directly or indirectly, by an owner-employee in repayment of any loan which under section 72(m)(4)(B) was treated as an amount received under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as a part of a plan described in section 403(a) shall be treated as a contribution to which this section applies on behalf of such owner-employee to such trust or to or under such plan.

SEC. 405. QUALIFIED BOND PURCHASE PLANS.

(a) REQUIREMENTS FOR QUALIFICATIONS.—A plan of an employer for the purchase for and distribution to his employees or their beneficiaries of United States bonds described in subsection (b) shall constitute a qualified bond purchase plan under this section if—

(1) the plan meets the requirements of section 401(a) (other than paragraphs (1), (2), and (12)) and, if applicable, the requirements of section 401(d) (other than paragraphs (1), (6)(B), and (8)); and

(2) contributions under the plan are used solely to purchase for employees or their beneficiaries United States bonds described in subsection (b).

(b) BONDS TO WHICH APPLICABLE.—

(1) CHARACTERISTICS OF BONDS.—This section shall apply only to a bond issued under the Second Liberty Bond Act, as amended, which by its terms, or by regulations prescribed by the Secretary under such Act—

(A) provides for payment of interest, or investment yield, only upon redemption;

(B) may be purchased only in the name of an individual;

(C) ceases to bear interest, or provide investment yield, not later than 5 years after the death of the individual in whose name it is purchased;

(D) may be redeemed before the death of the individual in whose name it is purchased only if such individual—

(i) has attained the age of 59½ years, or

(ii) has become disabled (within the meaning of section 213(g)(3)); and

(E) is nontransferable.

(2) MUST BE PURCHASED IN NAME OF EMPLOYEE.—This section shall apply to a bond described in paragraph (1) only if it is purchased in the name of the employee.

(c) DEDUCTION FOR CONTRIBUTIONS TO BOND PURCHASE PLANS.—Contributions paid by an employer to or under a qualified bond purchase plan shall be deductible in an amount determined under section 404(a) in the same manner and to the same extent as if such contributions were made to a trust described in section 401(a) which is exempt from tax under section 501(a).

(d) TAXABILITY OF BENEFICIARY OF QUALIFIED BOND PURCHASE PLAN.—

(1) GROSS INCOME NOT TO INCLUDE BONDS AT TIME OF DISTRIBUTION.—For purposes of this chapter, in the case of a distributee of a bond described in subsection (b) under a qualified bond purchase plan, or from a trust described in section 401(a) which is exempt from tax under section 501(a), gross income does not include any amount attributable to the receipt of such bond. Upon redemption of such bond, the proceeds shall be subject to taxation under this chapter, but the provisions of section 72 (relating to annuities, etc.) and section 1232 (relating to bonds and other evidences of indebtedness) shall not apply.

(2) BASIS.—The basis of any bond received by a distributee under a qualified bond purchase plan—

(A) if such bond is distributed to an employee, or with respect to an employee, who at the time of purchase of the bond, was not a self-employed individual within the meaning of section 401(c)(2), shall be the amount of the contributions by the employee which were used to purchase the bond, and

(B) if such bond is distributed to an individual, or with respect to an individual, who, at the time of purchase of the bond, was a self-employed individual within the meaning of section 401(c)(2), shall be the amount of the contributions used to purchase the bond which were made by or for such individual and were not allowed as a deduction under subsection (c).

The basis of any bond described in subsection (b) received by a distributee from a trust described in section 401(a) which is exempt from tax under section 501(a) shall be determined under regulations prescribed by the Secretary or his delegate.

(e) CAPITAL GAINS TREATMENT NOT TO APPLY TO BONDS DISTRIBUTED BY TRUSTS.—Section 402(a)(2) shall not apply to any bond described in subsection (b) distributed to any distributee and, for purposes of applying such section, any such bond distributed to any distributee and any such bond to the credit of any employee shall not be taken into account.

(f) Employee Defined.—For purposes of this section, the term "employee" includes an individual who is a self-employed individual within the meaning of section 401(c)(2), and the employer of such individual shall be the person treated as his employer under section 401(c)(5).

(g) Proof of Purchase.—At the time of purchase of any bond to which this section applies, proof of such purchase shall be furnished in such form as will enable the purchaser, and the employee in whose name such bond is purchased, to comply with the provisions of this section.

(h) Regulations.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the provisions of this section.

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Subchapter F—Exempt Organizations

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PART I—GENERAL RULE

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SEC. 503. REQUIREMENTS FOR EXEMPTION.

(a) Denial of Exemption to Organizations Engaged in Prohibited Transactions.—

(1) General rule.—

(A) An organization described in section 501(c)(3) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after July 1, 1950.

(B) An organization described in section 501(c)(17) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after December 31, 1959.

(C) An organization described in section 401(a) which is subject to the provisions of this section shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.

(2) Taxable years affected.—An organization described in section 501(c)(3) or (17) or section 401(a) shall be denied exemption from taxation under section 501(a) by reason of paragraph (1) only for taxable years after the taxable year during which it is notified by the Secretary or his delegate that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

(b) Organizations to Which Section Applies.—This section shall apply to any organization described in section 501(c) (3) or (17) or section 401(a) except—

(1) a religious organization (other than a trust);

(2) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(3) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or

performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public;

(4) an organization which is operated, supervised, controlled, or principally supported by a religious organization (other than a trust) which is itself not subject to the provisions of this section; and

(5) an organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research or agricultural research.

(c) PROHIBITED TRANSACTIONS.—For purposes of this section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of this section—

(1) lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

(2) pays any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) makes any part of its services available on a preferential basis to;

(4) makes any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

(5) sells any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth, to; or

(6) engages in any other transaction which results in a substantial diversion of its income or corpus to;

the creator of such organization (if a trust); a person who has made a substantial contribution to such organization; a member of the family (as defined in section 267(c)(4)) of an individual who is the creator of such trust or who has made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(d) FUTURE STATUS OF ORGANIZATIONS DENIED EXEMPTION.—Any organization described in section 501(c) (3) or (17) or section 401(a) which is denied exemption under section 501(a) by reason of subsection (a) of this section, with respect to any taxable year following the taxable year in which notice of denial of exemption was received, may, under regulations prescribed by the Secretary or his delegate, file claim for exemption, and if the Secretary or his delegate, pursuant to such regulations, is satisfied that such organization will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to taxable years after the year in which such claim is filed.

(e) DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.—No gift or bequest for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), otherwise allowable as

a deduction under section 170, 642(c), 545(b)(2), 2055, 2106(a)(2), or 2522, shall be allowed as a deduction if made to an organization described in section 501(c)(3) which, in the taxable year of the organization in which the gift or bequest is made, is not exempt under section 501(a) by reason of this section. With respect to any taxable year of the organization for which the organization is not exempt pursuant to subsection (a) by reason of having engaged in a prohibited transaction with the purpose of diverting the corpus or income of such organization from its exempt purposes and such transaction involved a substantial part of such corpus or income, and which taxable year is the same, or prior to the, taxable year of the organization in which such transaction occurred, such deduction shall be disallowed the donor only if such donor or (if such donor is an individual) any member of his family (as defined in section 267(c)(4)) was a party to such prohibited transaction.

(f) DEFINITION.—For purposes of this section, the term "gift or bequest" means any gift, contribution, bequest, devise, legacy, or transfer.

(g) SPECIAL RULE FOR LOANS.—For purposes of the application of subsection (c)(1), in the case of a loan by a trust described in section 401(a), the following rules shall apply with respect to a loan made before March 1, 1954, which would constitute a prohibited transaction if made on or after March 1, 1954:

(1) If any part of the loan is repayable prior to December 31, 1955, the renewal of such part of the loan for a period not extending beyond December 31, 1955, on the same terms, shall not be considered a prohibited transaction.

(2) If the loan is repayable on demand, the continuation of the loan without the receipt of adequate security and a reasonable rate of interest beyond December 31, 1955, shall be considered a prohibited transaction.

(h) SPECIAL RULES RELATING TO LENDING BY SECTION 401(a) AND SECTION 501(c)(17) TRUSTS TO CERTAIN PERSONS.—For purposes of subsection (c)(1), a bond, debenture, note, or certificate or other evidence of indebtedness (hereinafter in this subsection referred to as "obligation") acquired by a trust described in section 401(a) or section 501(c)(17) shall not be treated as a loan made without the receipt of adequate security if—

(1) such obligation is acquired—

(A) on the market, either (i) at the price of the obligation prevailing on a national securities exchange which is registered with the Securities and Exchange Commission, or (ii) if the obligation is not traded on such a national securities exchange, at a price not less favorable to the trust than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer;

(B) from an underwriter, at a price (i) not in excess of the public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, and (ii) at which a substantial portion of the same issue is acquired by persons independent of the issuer; or

(C) directly from the issuer, at a price not less favorable to the trust than the price paid currently for a substantial portion of the same issue by persons independent of the issuer;

(2) immediately following acquisition of such obligation—

(A) not more than 25 percent of the aggregate amount of obligations issued in such issue and outstanding at the time of acquisition is held by the trust, and

(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer; and

(3) immediately following acquisition of the obligation, not more than 25 percent of the assets of the trust is invested in obligations of persons described in subsection (c).

(i) LOANS WITH RESPECT TO WHICH EMPLOYERS ARE PROHIBITED FROM PLEDGING CERTAIN ASSETS.—Subsection (c)(1) shall not apply to a loan made by a trust described in section 401(a) to the employer (or to a renewal of such a loan or, if the loan is repayable upon demand, to a continuation of such a loan) if the loan bears a reasonable rate of interest, and if (in the case of a making or renewal)—

(1) the employer is prohibited (at the time of such making or renewal) by any law of the United States or regulation thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets;

(2) the making or renewal, as the case may be, is approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and no other such trustee had previously refused to give such written approval; and

(3) immediately following the making or renewal, as the case may be, the aggregate amount loaned by the trust to the employer, without the receipt of adequate security, does not exceed 25 percent of the value of all the assets of the trust.

For purposes of paragraph (2), the term "trustee" means, with respect to any trust for which there is more than one trustee who is independent of the employer, a majority of such independent trustees. For purposes of paragraph (3), the determination as to whether any amount loaned by the trust to the employer is loaned without the receipt of adequate security shall be made without regard to subsection (h).

(j) TRUSTS BENEFITING CERTAIN OWNER-EMPLOYEES.—

(1) PROHIBITED TRANSACTIONS.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(4)) who control (within the meaning of section 401(d)(9)(B)), the trade or business with respect to which the plan is established, the term "prohibited transaction" also means any transaction in which such trust, directly or indirectly—

(A) lends any part of the corpus or income of the trust to;

(B) pays any compensation for personal services rendered to the trust to;

(C) makes any part of its services available on a preferential basis to; or

(D) acquires for the trust any property from, or sells any property to;

any person described in subsection (c) or to any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(2) SPECIAL RULE FOR LOANS.—For purposes of the application of paragraph (1)(A), the following rules shall apply with respect to a loan made before the date of the enactment of this subsection which would be a prohibited transaction if made in a taxable year beginning after December 31, 1961:

(A) If any part of the loan is repayable prior to December 31, 1964, the renewal of such part of the loan for a period not extending beyond December 31, 1964, on the same terms, shall not be considered a prohibited transaction.

(B) If the loan is repayable on demand, the continuation of the loan beyond December 31, 1964, shall be considered a prohibited transaction.

Subchapter L—Insurance Companies

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PART I—LIFE INSURANCE COMPANIES

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Subpart B—Investment Income

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SEC. 805. POLICY AND OTHER CONTRACT LIABILITY REQUIREMENTS.

(a) IN GENERAL.— * * *

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(d) PENSION PLAN RESERVES.—

(1) PENSION PLAN RESERVES DEFINED.—For purposes of this part, the term "pension plan reserves" means that portion of the life insurance reserves which is allocable to contracts—

(A) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be (i) trusts described in section 401(a) and exempt from tax under section 501(a), or (ii) trusts exempt from tax under section 165 of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws;

(B) purchased under contracts entered into under plans which (as of the time the contracts were entered into) were deemed to be plans [meeting the requirements of section 401(a) (3), (4), (5), and (6), or] *described in section 403(a), or plans meeting* the requirements of section 165(a) (3), (4), (5), and (6) of the Internal Revenue Code of 1939;

(C) provided for employees of the life insurance company under a plan which, for the taxable year, meets the requirements of section [401(a) (3), (4), (5), and (6);] *401(a)*

(other than paragraphs (1), (2), and (12)) and, in the case of a plan described in section 404(a)(9), which meets the requirements of section 401(d) (other than paragraphs (1), (3), and (4)); or

(D) purchased to provide retirement annuities for its employees by an organization which (as of the time the contracts were purchased) was an organization described in section 501(c)(3) which was exempt from tax under section 501(a) or was an organization exempt from tax under section 101(6) of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws.

(2) SPECIAL TRANSITIONAL RULE.—For purposes of this part, the amount taken into account as pension plan reserves shall be—

(A) in the case of a taxable year beginning after December 31, 1957, and before January 1, 1959, zero;

(B) in the case of a taxable year beginning after December 31, 1958, and before January 1, 1960, 33⅓ percent of the amount thereof (determined without regard to this paragraph);

(C) in the case of a taxable year beginning after December 31, 1959, and before January 1, 1961, 66⅔ percent of the amount thereof (determined without regard to this paragraph); and

(D) in the case of a taxable year beginning after December 31, 1960, 100 percent of the amount thereof.

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Subchapter R—Election of Certain Partnerships and Proprietorships as to Taxable Status

Sec. 1361. Unincorporated business enterprises electing to be taxed as domestic corporations.

SEC. 1361. UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.

(a) GENERAL RULE.—Subject to the qualifications in subsection (b), an election may be made, in accordance with regulations prescribed by the Secretary or his delegate, not later than 60 days after the close of any taxable year of a proprietorship or partnership owning an unincorporated business enterprise, by the proprietor or all the partners, owning an interest in such enterprise at any time on or after the first day of the first taxable year to which the election applies or of the year described in subsection (f), to be subject to the taxes described in subsection (h) as a domestic corporation for such year and subsequent years.

(b) QUALIFICATIONS.—The election described in subsection (a) may not be made with respect to an unincorporated business enterprise unless at all times during the period on or after the first day of the first taxable year to which the election applies or of the year described in subsection (f), as the case may be, and on or before the date of election—

(1) such enterprise is owned by an individual, or by a partnership consisting of not more than 50 individual members;

(2) no proprietor or partner having more than a 10 percent interest in profits or capital of such enterprise is a proprietor or a

partner having more than a 10 percent interest in profits or capital of any other unincorporated business enterprise taxable as a domestic corporation;

(3) no proprietor or partner of such enterprise is a nonresident alien or a foreign partnership; and

(4) such enterprise is one in which capital is a material income producing factor, or 50 percent or more of the gross income of such enterprise consists of gains, profits, or income derived from trading as a principal or from buying and selling real property, stock, securities, or commodities for the account of others.

(c) CORPORATE PROVISIONS APPLICABLE.—Under regulations prescribed by the Secretary or his delegate, an unincorporated business enterprise as to which an election has been made under subsection (a), shall, except as provided in subsection (m), be considered a corporation for purposes of this subtitle, except chapter 2 thereof, with respect to operation, distributions, sale of an interest, and any other purpose; and each owner of an interest in such enterprise shall be considered a shareholder thereof in proportion to his interest.

[(d) LIMITATION.—A partner or proprietor of an unincorporated business enterprise as to which an election has been made under subsection (a) shall not be considered an employee for purposes of section 401(a) (relating to employees' pension trusts, etc.).]

(d) LIMITATION.—For purposes of sections 401(a) (relating to employees pension trusts, etc.) and 405 (relating to qualified bond purchase plans), a partner or proprietor of an unincorporated business enterprise as to which an election has been made under subsection (a) shall not be considered an employee other than as a self-employed individual within the meaning of section 401(c)(2).

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Subtitle B—Estate and Gift Taxes

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CHAPTER 11—ESTATE TAX

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Subchapter A—Estates of Citizens or Residents

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PART III—GROSS ESTATE

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SEC. 2039. ANNUITIES.

(a) GENERAL.—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any

period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) AMOUNT INCLUDIBLE.—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit-sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

(c) EXEMPTION OF ANNUITIES UNDER CERTAIN TRUSTS AND PLANS.—Notwithstanding the provisions of this section or of any provision of law, there shall be excluded from the gross estate the value of an annuity or other payment receivable by any beneficiary (other than the executor) under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at at the time of decedent's separation from employment (by death or otherwise), or at the time of termination of the plan if earlier, [met the requirements of section 401(a) (3), (4), (5), and (6)] *was a plan described in section 403(a)*; or

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503(b) (1), (2), or (3), and which is exempt from tax under section 501(a).

If such amounts payable after the death of the decedent under a plan described in paragraph (1) or (2) or under a contract described in paragraph (3) are attributable to any extent to payments or contributions made by the decedent, no exclusion shall be allowed for that part of the value of such amounts in the proportion that the total payments or contributions made by the decedent bears to the total payments or contributions made. For purposes of this subsection, contributions or payments made by the decedent's employer or former employer under a trust or plan described in paragraph (1) or (2) shall not be considered to be contributed by the decedent, and contributions or payments made by the decedent's employer or former employer toward the purchase of an annuity contract described in paragraph (3) shall, to the extent excludable from gross income under section 403(b), not be considered to be contributed by the decedent. *For purposes of this subsection, contributions or payments on behalf of the decedent while he was a self-employed individual within the meaning of section 401(c)(2) made under a trust or plan described in paragraph (1) or (2) shall be considered to be contributions or payments made by the decedent.*

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CHAPTER 12—GIFT TAX

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Subchapter B—Transfers

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SEC. 2517. CERTAIN ANNUITIES UNDER QUALIFIED PLANS.

(a) GENERAL RULE.—The exercise or nonexercise by an employee of an election or option whereby an annuity or other payment will become payable to any beneficiary at or after the employee's death shall not be considered a transfer for purposes of this chapter if the option or election and annuity or other payment is provided for under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, [met the requirements of section 401(a) (3), (4), (5), and (6)] *was a plan described in section 403(a)*; or

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503(b) (1), (2), or (3), and which is exempt from tax under section 501(a).

(b) TRANSFERS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—If the annuity or other payment referred to in subsection (a) is attributable to any extent to payments or contributions made by the employee, then subsection (a) shall not apply to that part of the value of such annuity or other payment which bears the same proportion to the total value of the annuity or other payment as the total payments or contributions made by the employee bear to the total payments or contributions made. For purposes of the preceding sentence, payments or contributions made by the employee's employer or former employer toward the purchase of an annuity contract described in subsection (a)(3) shall, to the extent not excludable from gross income under section 403(b), be considered to have been made by the employee. *For purposes of this subsection, payments or contributions on behalf of an individual while he was a self-employed individual within the meaning of section 401(c)(2) made under a trust or plan described in subsection (a) (1) or (2) shall be considered to be payments or contributions made by the employee.*

(c) EMPLOYEE DEFINED.—For purposes of this section, the term "employee" includes a former employee.

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Subtitle C—Employment Taxes

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CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

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SEC. 3306. DEFINITIONS.

(a) EMPLOYER.—* * *

(b) WAGES.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—

(1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $3,000 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to $3,000 to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) retirement, or

(B) sickness or accident disability, or

(C) medical or hospitalization expenses in connection with sickenss or accident disability, or

(D) death;

(3) any payment made to an employee (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) on account of retirement;

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness

or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which s exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust, or

(B) under or to an annuity plan which, at the time of such payment, [meets the requirements of section 401(a) (3), (4), (5), and (6);] *is a plan described in section 403(a), or*

(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a);

(6) the payment by an employer (without deduction from the remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101 (or the corresponding section of prior law), or

(B) of any payment required from an employee under a State unemployment compensation law;

(7) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business;

(8) any payment (other than vacation or sick pay) made to an employee after the month in which he attains the age of 65, if he did not work for the employer in the period for which such payment is made.

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

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SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service as a member of the Armed Forces of the United States performed in a month for which such member is entitled to the benefits of section 112; or

(2) for agricultural labor (as defined in section 3121(g)); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For pur-

poses of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for services performed by a nonresident alien individual, other than—

(A) a resident of a contiguous country who enters and leaves the United States at frequent intervals; or

(B) a resident of Puerto Rico if such services are performed as an employee of the United States or any agency thereof; or

(7) for such services, performed by a nonresident alien individual who is a resident of a contiguous country and who enters and leaves the United States at frequent intervals, as may be designated by regulations prescribed by the Secretary or his delegate; or

(8) (A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10) (A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, [meets the requirements of section 401(a) (3), (4), (5), and (6)] *is a plan described in section 403(a); or*

(C) under or to a bond purchase plan which, at the time of such payment is a qualified bond purchase plan described in section 405(a).

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART III—INFORMATION RETURNS

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Subpart B—Information Concerning Transactions With Other Persons

Sec. 6041. Information at source.
Sec. 6042. Returns regarding corporate dividends, earnings, and profits.
Sec. 6043. Return regarding corporate dissolution or liquidation.
Sec. 6044. Returns regarding patronage dividends.
Sec. 6045. Returns of brokers.
Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.
Sec. 6047. Information relating to certain trusts and annuity and bond plans.

SEC. 6041. INFORMATION AT SOURCE.

(a) PAYMENTS OF $600 OR MORE.—All persons engaged in a trade or business and making payment in the course of such trade or busi-

ness to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 6042(1) or section 6045), of $600 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Secretary or his delegate, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary or his delegate, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) COLLECTION OF FOREIGN ITEMS.—In the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by any person undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange, such person shall make a return according to the forms or regulations prescribed by the Secretary or his delegate, setting forth the amount paid and the name and address of the recipient of each such payment.

(c) PAYMENTS OF INTEREST BY CORPORATIONS.—Every corporation making payments of interest, regardless of amounts, shall, when required by regulations of the Secretary or his delegate, make a return according to the forms or regulations prescribed by the Secretary or his delegate, setting forth the amount paid and the name and address of the recipient of each such payment.

(d) RECIPIENT TO FURNISH NAME AND ADDRESS.—When necessary to make effective the provisions of this section, the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

SEC. 6042. RETURNS REGARDING CORPORATE DIVIDENDS, EARNINGS, AND PROFITS.

Every corporation shall, when required by the Secretary or his delegate—

(1) Make a return of its payments of dividends, stating the name and address of, the number of shares owned by, and the amount of dividends paid to, each shareholder;

(2) Furnish to the Secretary or his delegate a statement of such facts as will enable him to determine the portion of the earnings or profits of the corporation (including gains, profits, and income not taxed) accumulated during such periods as the Secretary or his delegate may specify, which have been distributed or ordered to be distributed, respectively, to its shareholders during such taxable years as the Secretary or his delegate may specify; and

(3) Furnish to the Secretary or his delegate a statement of its accumulated earnings and profits and the names and addresses of the individuals or shareholders who would be entitled to such accumulated earnings and profits if divided or distributed, and of the amounts that would be payable to each.

SEC. 6043. RETURN REGARDING CORPORATE DISSOLUTION OR LIQUIDATION.

Every corporation shall—

(1) Within 30 days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, make a return setting forth the terms of such resolution or plan and such other information as the Secretary or his delegate shall by forms or regulations prescribe; and

(2) When required by the Secretary or his delegate, make a return regarding its distributions in liquidation, stating the name and address of, the number and class of shares owned by, and the amount paid to, each shareholder, or, if the distribution is in property other than money, the fair market value (as of the date the distribution is made) of the property distributed to each shareholder.

SEC. 6044. RETURNS REGARDING PATRONAGE DIVIDENDS.

(a) PAYMENTS OF $100 OR MORE.—Any corporation allocating amounts as patronage dividends, rebates, or refunds (whether in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the amount of such dividend, refund, or rebate) shall make a return showing—

(1) The name and address of each patron to whom it has made such allocations amounting to $100 or more during the calendar year; and

(2) The amount of such allocations to each patron.

(b) PAYMENTS REGARDLESS OF AMOUNT.—If required by the Secretary or his delegate, any such corporation shall make a return of all patronage dividends, rebates, or refunds made during the calendar year to its patrons.

(c) EXCEPTIONS.—This section shall not apply in the case of any corporation (including any cooperative or nonprofit corporation engaged in rural electrification) described in section 501(c) (12) or (15) which is exempt from tax under section 501(a), or in the case of any corporation subject to a tax imposed by subchapter L of chapter 1.

SEC. 6045. RETURNS OF BROKERS.

Every person doing business as a broker shall, when required by the Secretary or his delegate, make a return, in accordance with such regulations as the Secretary or his delegate may prescribe, showing the names of customers for whom such person has transacted any business, with such details regarding the profits and losses and such other information as the Secretary or his delegate may by forms or regulations require with respect to each customer as will enable the Secretary or his delegate to determine the amount of such profits or losses.

SEC. 6046. RETURNS AS TO CREATION OR ORGANIZATION, OR REORGANIZATION, OF FOREIGN CORPORATIONS.

(a) GENERAL RULE.—On or before the 90th day after the creation or organization, or reorganization, of any foreign corporation—

(1) Each United States citizen or resident who was an officer or director of the corporation at any time within 60 days after the creation or organization, or reorganization thereof, and

(2) Each United States shareholder of the corporation by or for whom, at any time within 60 days after the creation or organization or reorganization of the corporation, 5 percent or more in value of the stock of the corporation then outstanding was owned directly or indirectly (including, in the case of an individual, stock owned by members of his family),

shall make a return in compliance with the provisions of subsection (b).

(b) FORM AND CONTENTS OF RETURNS.—The returns required by subsection (a) shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary or his delegate prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws.

(c) MEANING OF TERMS.—For the purpose of this section—

(1) UNITED STATES SHAREHOLDER.—The term "United States shareholder" includes a citizen or resident of the United States, a domestic corporation, a domestic partnership or an estate or trust (other than an estate or trust the gross income of which under subtitle A includes only income from sources within the United States).

(2) MEMBERS OF FAMILY.—The family of an individual shall be considered as including only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(d) CROSS REFERENCE.—

For provisions relating to penalties for violations of this section, see section 7203.

SEC. 6047. INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY AND BOND PURCHASE PLANS.

(a) TRUSTEES AND INSURANCE COMPANIES.—The trustee of a trust described in section 401(a) which is exempt from tax under section 501(a) to which contributions have been paid under a plan by or for any owner-employee (as defined in section 401(c)(4)), and each insurance company which is the issuer of a contract purchased by such a trust, or purchased under a plan described in section 403(a), contributions for which have been paid by or for any owner-employee, shall file such returns (in such form and at such times), keep such records, make such identification of contracts and funds (and accounts within such funds), and supply such information, as the Secretary or his delegate shall by forms or regulations prescribe.

(b) OWNER-EMPLOYEES.—Every individual by or for whom contributions have been paid as an owner-employee (as defined in section 401(c)(4))—

(1) to a trust described in section 401(a) which is exempt from tax under section 501(a), or

(2) to an insurance company under a plan described in section 403(a),

shall furnish the trustee or insurance company, as the case may be, such information at such times and in such form and manner as the Secretary or his delegate shall prescribe by forms or regulations.

(c) EMPLOYEES UNDER QUALIFIED BOND PURCHASE PLANS.—Every individual in whose name a bond described in section 405(b)(1) is purchased by his employer under a qualified bond purchase plan described in section 405(a), or by a trust described in section 401(a) which is exempt from tax under section 501(a), shall furnish—

(1) to his employer or to such trust, and

(2) to the Secretary (or to such person as the Secretary may by regulations prescribe),

such information as the Secretary or his delegate shall by forms or regulations prescribe.

(d) Cross Reference.—

For criminal penalty for furnishing fraudulent information, see section 7207.

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CHAPTER 75—CRIMES, OTHER OFFENSES, AND FORFEITURES

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Subchapter A—Crimes

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PART I—GENERAL PROVISIONS

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SEC. 7207. FRAUDULENT RETURNS, STATEMENTS, OR OTHER DOCUMENTS.

Any person who willfully delivers or discloses to the Secretary or his delegate any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter, shall be fined not more than $1,000, or imprisoned not more than 1 year, or both. *Any person required pursuant to section 6047(b) to furnish any information to any trust, any insurance company, his employer, or the Secretary who willfully furnishes any information known by him to be fraudulent or to be false as to any material matter shall be fined not more than $1,000, or imprisoned not more than 1 year, or both.*

MINORITY VIEWS

H.R. 10 is concerned with the important subject of the establishment of tax-deferred retirement programs by the self-employed with respect to themselves and their employees. The purported purpose of the legislation is to establish a reasonable identity in the tax treatment of these individuals with respect to retirement plans as is accorded to corporate employees under present law.

The legislation makes a gesture toward tax equity in this area but unfortunately fails to achieve sufficient identity of treatment. Because the bill does not accomplish its intended purpose and because of the present fiscal posture of the Federal Government, the revenue loss from the enactment of the bill estimated by the Treasury Department at $358 million in the first full year of operation cannot be condoned at this time. The signatories to these views urge that the supporters of this legislation endeavor to have it taken into account in future Government budgeting so that its effect on fiscal balance need not be considered as a factor in evaluating the merits of the bill.

We recognize that an inequity does exist in present law in that certain of our citizens are allowed, and others are not, to participate in tax deferred pension plans. H.R. 10 would not equalize the tax treatment of our citizens in providing for retirement security but would instead result in the existence of different methods of tax treatment operating side by side, each applicable to a different group of taxpayers.

For example, these disparities would either be continued or created under this legislation: (1) Individuals working for self-employed employers not employing as many as four persons could continue to be discriminated against and precluded from participating in a retirement program; (2) contributions with respect to employees would be limited to earned income whereas contributions with respect to the self-employed would be on self-employment income, including both earnings and return on investment in the business; (3) lump-sum distributions in the case of the self-employed would be treated as ordinary income whereas such distributions to employees would be accorded capital gain treatment; (4) the vesting of an interest in a program would vary so that in the case of the self-employed and their employees (if four or more employees) a nonforfeitable right would attach immediately, but in the case of other types of beneficiaries such right may be forfeitable or nonforfeitable; and (5) various sets of limitations affecting coverage, contributions, and distributions would exist under the different statutory tests that would be applicable.

In seeking to ameliorate the present acknowledged discrimination in tax treatment with respect to retirement security, we must necessarily endeavor to achieve substantially similar treatment of all taxpayers. H.R. 10 would create more disparities than it would remove. In the area dealt with by this bill the details are important and we cannot responsibly limit our concern only to basic general principles.

It is entirely possible that precedents would be created under this legislation that could potentially unduly restrict programs to be established under the new authority or tend to impair existing programs. The fact that there is a problem to be solved in this area does not mean that we accept just any solution.

In the above enumeration of disparities reference was made in item (2) to the fact that contributions with respect to employees would be restricted to a percentage relation to earned salaries whereas in the case of the self-employed the restriction would apply to a percentage relation to self-employment income. It is significant to note that $100 million of the $358 million revenue loss is attributable to this more liberal definition of income for the self-employed.

The present version of H.R. 10 contains numerous and significant changes from the versions that have been previously considered by the House. Because this is a different bill, we are of the view that the committee did not give the careful consideration to the changes that they required.

For the above-stated reasons, we are constrained to oppose the enactment of H.R. 10 in its present form.

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