PENSION PLANS: THEIR BACKGROUND, CURRENT TRENDS, AND AN AGENDA FOR INQUIRY

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The problems of unemployment and retirement have been thrust into sharp focus by President Lyndon B. Johnson's State of the Union address in which the President called for an unconditional war on poverty. This stress on poverty in our time is paradoxical: although there are many people with inadequate incomes, there is a smaller percentage of such people now than at any time in the past. The problem of the inadequate income group has been analyzed during the past years from many perspectives.[1] An estimated twenty per cent of the population falls within this classification, which is not limited to outright poverty in all instances.[2] No matter what its scope, this group is the subject of growing concern.

Two principal questions to be answered are: who are the individuals in this inadequate income group and why are they part of it? The group composition is forty per cent over age sixty-five; thirty-three per cent women living alone or as heads of families; twenty per cent non-whites; and a miscellaneous group including, for example, the physically disabled. Four major individual disabilities which lead to inclusion in the inadequate income group are: poor education; physical or mental deficiency; restricted job opportunities due to race; and location in the wrong geographical area. People with inadequate incomes are far from a homogeneous group and inclusion within the group is dependent on many factors, but the characteristic which appears to be present in most cases is lack of education.

Progress in the fight against inadequate income has been achieved to a degree by the economic growth of the nation, and by public and private measures which serve to redistribute income. For example, since 1950, beneficiaries of private pension and de-

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[1] Galbraith, The Affluent Society (1958); Morgan, David, Cohen & Brazer, Income and Welfare in the United States (1962).

[2] A survey appearing in the February 17, 1964, issue of Newsweek Magazine at page 19 indicates that most of this group have so-called luxury items such as new cars, television sets, and electric appliances.

ferred profit sharing plans have increased fourfold and their benefits have increased sixfold; the number of social security recipients has risen sixfold and their benefits sixteenfold. The institution of unemployment compensation and other fringe benefits have also played a part in the general progress.[3] An offsetting factor which stimulates governmental and individual concern is the rapid increase of the population over age sixty-five. It is with the provision of adequate income for this group that this paper will be concerned.

BACKGROUND

With the industrial revolution and the resulting highly industrialized economy of the United States, it became evident that a primary need of the individual, beyond that of current subsistence, was that of financial security in old age. Rapid advances made by the medical profession increased life expectancy by astounding jumps. It became incumbent upon the individual to earn enough during his productive years to support himself and his family, and to save enough to carry him through the non-productive years which would follow.

Our forefathers sought to achieve some measure of post-retirement financial security through individual investment and savings, or through continued operation of their businesses, either directly or through family efforts. Progressive taxation of current income created unforeseen difficulties for such simple programs. The introduction of life insurance and annuities produced an artificial mode of estate creation and was an early attempt by progressive individuals to solve the problem of inadequate post-retirement income. It was this early realization that group action provided a means of accomplishing what the individual was unable to do alone that laid the predicate for later mass coverage and group savings programs. Insurance, however, was not the answer for the great majority of individuals, and business men as early as 1875 turned to the concept of a private pension plan to provide post-retirement income.

With the limitations on direct wage increases enforced by wage stabilization policies during World War II, workers became more interested in indirect benefits. Employers, encumbered by high corporate and excess profits taxes, sought means of reducing their tax burden while limiting the mobility of their skilled work force and attracting scarce employees of executive caliber.

The Internal Revenue Code of 1942 contained provisions which made the employer's contribution to pension plans a deductible

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3 The Chase Manhattan Bank, Business in Brief, Jan.-Feb. 1964.

business expense.[4] This addition to the Code increased the attractiveness of income deferral provisions to employers, just as high personal income taxes had increased the attractiveness of those provisions to high salaried personnel. Thus the fact that deferral provisions produced a welcome degree of income averaging for the employee and an equally welcome deduction for the employer tended greatly to enhance the desirability of pension plans.

Interest in pension programs was further increased by the position of the National Labor Relations Board and the *Inland Steel* decision of 1948. The position taken by the Supreme Court the following year, that a pension plan was a bargainable issue, acted as a springboard for the rapid expansion of private pension programs into the mass employee area.[5]

Notwithstanding the interest in the private area, employee coverage by private plans was so small during the early years of the development of these programs that the government found itself propelled into a broad social program: Social Security and survivor benefits became an integral part of the fiscal policy of the worker after 1930, as had railroad retirement programs, veterans' pensions and public assistance programs before. The basic desire of the individual for independence and avoidance of the stigma of government aid led to increasing pressures for private programs rather than to strenuous implementation of governmental programs.

The information available from the monthly labor reviews issued by the Department of Labor indicates that within a civilian labor force of over sixty-eight million in 1958 there was an apparent maximum potential pension coverage of approximately forty-two million workers, of whom only nineteen million were covered by plans. This is only twenty-seven per cent of those eligible.[6] The coverage had increased in 1961 to over twenty-two million, but the total labor force had increased as well.

In a period of gradually expanding coverage, many of those workers not covered had been effectively precluded by their employers' financial condition; others were not covered because they were self-employed or unemployed. This created an unde-

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[4] Int. Rev. Code of 1942, § 162A. This section is the forerunner of Int. Rev. Code of 1954, § 401.

[5] Inland Steel Co. v. NLRB, 170 F.2d 247 (7th Cir. 1948), *cert. denied,* 336 U.S. 960 (1949). Profit sharing plans were later covered by the decision in Black-Clawson Co., 103 N.L.R.B. 928, 210 F.2d 523 (6th Cir. 1953).

[6] Holland, "Some Characteristics of Private Pension Plans," in 2 Staff of House Comm. on Ways and Means, Tax Revision Compendium 1301, 1306, table 3 (Comm. Print. 1959).

sirable situation. Pressure for tax equalization led to the passage of the so-called Keogh legislation.[7]

It is upon this tableau of pressures and problems that is impressed the pattern of present change described herein. This change is not without critics: Robert Tilove has indicated that pension programs represent an inherent danger to our society in their limitation on the mobility of labor and their concentration of economic power.[8] Such comments are not without merit at a time when the misuse of pension funds has resulted in legislation to review the operation and control of labor union funds[9] and extension of the Internal Revenue Code to control use of funds and limit discriminatory practices.[10]

Current Trends

In observing the trends in employee benefit plans, the areas which merit the greatest comment are the modes of funding plans, the coverage of employees and the effect of the plans on employee mobility. Each of these areas will be given separate consideration.

Modes of Funding

Funding is the process of accumulating funds necessary to pay retirement benefits when due. Reserves are maintained through insurance of one form or another, investment in corporate securities, or other non-insured funds or capital investments. The growth and dimension of these funds are staggering. Table I indicates the assets of private funds over a period of years. These figures do not consider the government accumulations in the Social Security and Survivor Benefit programs.

TABLE I

	Book value end of the year (billions of dollars)					
	1957	*1958*	*1959*	*1960*	*1961*	*1962*
Insured pension reserves	14.1	15.6	17.6	18.8	20.2	21.6
Non-insured corporate pension funds	19.3	22.1	25.3	28.7	32.4	36.0
Other non-insured funds (union administered, non profit, etc.)	1.5	1.8	2.0	2.3	2.7	3.0
TOTAL	34.9	39.5	44.9	49.9	55.3	60.7

Source: Securities & Exchange Commission Statistical Service Series, Release No. 1902, May 24th, 1963.

[7] Self-Employed Individuals Retirement Act of 1962, 76 Stat. 809 (1962), amending Int. Rev. Code of 1954.

[8] Tilove, Pension Funds and Economic Freedom (1959).

[9] Welfare and Pension Plans Disclosure Act, 72 Stat. 997 (1958), as amended by 76 Stat. 35 (1962), 29 U.S.C. §§ 301-309.

[10] As the trust is to be administered for the exclusive benefit of the employees

There appears to be a progressive and steady growth of all forms of plans, with the largest portion of funds being retained in the non-insured corporate pension funds. The greater portion of the receipts have been invested in corporate securities, government bonds, mortgages, and common stocks. Table II indicates the distribution of the assets of these corporate pension funds.

Table II

Assets of Corporate Pension Funds (millions of dollars)
Book Value, End of Year

	1957	*1958*	*1959*	*1960*	*1961*	*1962*
Cash & Deposits.....	368	383	407	418	485	513
U. S. Gov't. Securities	2,032	1,985	2,148	2,034	2,064	2,215
Corp. Bonds						
Own Company	641	638	674	736	755	853
Other Companies...	9,751	11,094	12,124	13,403	14,366	15,213
Preferred Stocks	611	655	657	652	633	613
Common Stock						
Own Company	584	646	773	874	1,025	1,167
Other Companies...	4,187	5,396	6,940	8,638	10,774	12,752
Mortgages	313	405	576	753	907	1,140
Other Assets	833	892	1,008	1,197	1,359	1,533
TOTAL ASSETS ...	19,319	22,094	25,307	28,706	32,368	35,999

Source: Securities & Exchange Commission Statistical Service Series, Release No. 1902, May 24th, 1963.

The distribution of the resources of the pension funds set out in Table II indicates the reinvestment of the reserves in industry, with the possible purpose of continuing some measure of control of the source of the funds. This type of investment is sensible and desirable because it places the funds of the beneficiaries at work to build the source of the contributions.

Even in those plans which are funded to a substantial degree by insurance, the form of funding has changed substantially. Until 1930, most insured group retirement plans were funded under the group annuity method. The increased desire for flexibility in recent years has resulted in a trend toward deposit administration funding. This trend has been accelerated because of the adaptability of

under Int. Rev. Code of 1954, § 401(a), use of company stock in the funding of the trust or purchase of company stock with funds of the trust may be scrutinized and penalties may be imposed if the transactions are not properly handled. See Casey, "Using Company Stock in Employee Plans," N.Y.U. 14th Inst. on Fed. Tax 1301 (1957).

this method of funding to the negotiated type of plan. Since 1958 six out of every ten plans have been of this type.[11]

Many of the negotiated plans are funded by investments made through the trustees of the plans and little is presently known of the distribution of the assets of these funds. The recent legislation[12] requiring the presentation of information concerning the funds may permit some light to be thrown on the subject. A certain degree of notoriety has been achieved by the Teamsters Union's investment program which might be an indicator of the interest of unions in mortgage financing, but this is too narrow a source of information to be acceptable in drawing conclusions.

Coverage of Employees

Generally speaking, eligibility of the employee to participate in a deferred compensation plan is determined by the class in which the employee may be categorized. The Internal Revenue Code of 1954, as did its predecessor, permits a certain degree of discrimination in classifying employees. The plan may, for example, cover salaried employees, workers paid an hourly wage, union members, or employees with earnings in excess of 4,800 dollars per year.[13] The method of classification chosen will not be disturbed provided it is uniform and does not discriminate in favor of the company's officers, stockholders, key personnel (supervisors and other highly paid employees), or any others who might fall into the so-called "prohibited group."[14]

GROWTH OF COVERAGE

A review of the growth of coverage in plans indicates that the number of workers participating in pension plans has increased radically in a relatively short space of time. The characteristics of the plans vary, about one-quarter being insurance company trusteed plans, and the remaining three-quarters being divided between single employer plans and the multi-employer plans. The latter type of plan is designed to cover workers of all employers in a particular industry, and generally in a specific geographical area. Table III indicates the degree of coverage growth over the past twelve years.

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[11] Connecticut General Life Insurance Company, Facts and Trends in Insured Pension Plans From An Analysis of 900 Group Plans (1962).

[12] See note 9, *supra*.

[13] This figure is the present maximum sum of earnings upon which contributions to Social Security are made.

[14] Int. Rev. Code of 1954, § 401(a)(4); the term "prohibited group" is used in Gordon, "Qualifying a Pension or Profit Sharing Plan Under I.R.C.," in Taxation of Deferred Employee and Executive Compensation 125, 126 (Sellin ed. 1960).

TABLE III

Private Pension & Deferred Profit Sharing Plans[a]
Estimated Coverage, end of year, (in thousands)[b]

Year	*Total*	*Insured*	*Non-Insured*
1950	9,800	2,600	7,200
1951	11,000	2,900	8,100
1952	11,700	3,200	8,500
1953	13,200	3,400	9,800
1954	14,200	3,600	10,600
1955	15,400	3,800	11,600
1956	16,800	4,000	12,800
1957	18,200	4,400	13,800
1958	19,000	4,500	14,500
1959	20,200	4,800	15,400
1960	21,600	4,900	16,700
1961	22,600	5,100	17,500

[a] Includes pay-as-you-go, multi-employer, and union administered plans, those of nonprofit organizations and railroad plans supplementing the Federal Railroad retirement program. Insured plans are underwritten by insurance companies; non-insured plans are in general funded through trustees.

[b] Excludes annuitants.

Source: Social Security Administration, Division of the Actuary.

Despite the apparent rapid growth of coverage, only a minority of the labor force is covered by private pension plans. The figures in the tables are slightly misleading when used as a basis of comparison because the labor force shown to be covered does not include government workers, railroad employees (other than those with supplemental plans) or others who may be covered by other forms of plans. The total labor force in 1958 consisted of 68,647,000 of which only 19,000,000 were covered by plans.[15] This total labor force included unemployed and agricultural laborers, as well as the self-employed. A reappraisal of the figures would then indicate that about forty-five per cent of those who could conceivably be covered by private pension plans are so covered. If the trend in growth of coverage continues, a greater percentage may eventually be covered. However, there is an inherent difficulty in predicting effective coverage expansion due to the changing pattern of the labor force and its steady numerical growth.

Coverage provisions may act as a limiting factor on the participation of employees in the plans. This limitation is accomplished by vesting provisions or benefit formulas and is influenced markedly by retirement policy. The plans will often place qualifications for participation in the form of attainment of a certain age or the

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[15] These figures are extracted from Table 3 in Holland, *op. cit. supra* note 6.

completion of a number of years of service, or both, *e.g.* age thirty and three years of service. Many of the plans have a maximum age limit included in the eligibility requirements excluding workers aged sixty or sixty-five, or older.[16] Further limitation in the requirement of minimum terms of participation prior to retirement is quite common. A survey of 900 group plans has indicated that the prevalent elgibility requirement in the deposit administration plan [17] is ten years of service at retirement, with a recent growth in the use of a fifteen year service requirement.[18]

BENEFIT FORMULAS

Retirement benefits are usually based upon a formula which recognizes one or both of two prime factors, length of service and earnings. Generally speaking, if both are recognized in the plan the formula is one of the "fixed benefit" type, *e.g.*, one per cent of earnings for each year of service. Where there is no recognition of earnings, the formula is known as a "flat benefit" plan, *e.g.*, two dollars a month for each year of service. The latter is the type most commonly used in the majority of union negotiated plans, with the additional limitation of a maximum number of years of service creditable to the pension.

Occasionally a plan will present no definite formula for the determination of a pension, but instead will specify a percentage of annual salary which will be used to purchase such an annuity as the contribution permits. This type of plan is known as a "money purchase plan" and is commonly used in insured profit sharing plans. Where the company desires to cover salaried and hourly employees under one plan, it is common to combine the flat and fixed benefit formulas. The flat benefit portion provides benefits on earnings in excess of the social security benefits.

There appears to be a trend toward combination plans, with money purchase plans steadily declining in favor. A review of the plans most commonly used indicates that the fixed benefit type is used in a majority of cases, as the trend is for closer integration with social security benefits.

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16 Such limitations are not destructive of qualification of a plan provided they are not intended to discriminate.

17 Connecticut General Life Insurance Company, *op. cit. supra* note 1. Deposit administration indicates a type of plan under which contributions are accumulated in a fund at interest until an employee retires, at which time a lifetime annuity is purchased by withdrawing the necessary premium from the fund.

18 Rice & Schlaudt, Basic Pension and Profit Sharing Plans 13 (1957); see also Strecker, "Taxation of Retirement Provision," 27 Law & Contemp. Prob. 67 (1962).

An examination of the integrated plans indicates that plans of this type favor the highly paid employees. The Internal Revenue Service has indicated that integrated plans will not be considered discriminatory provided that the benefits received with respect to earnings above the social security ceiling shall not be proportionately greater than the social security benefits themselves.[19] Thus many small companies can obtain significant benefits for their officers without fear of disqualification of the plan as discriminatory. This appears to be incongruous in view of the provisions of the code,[20] where the distinct intent is expressed to avoid discrimination in favor of officers, shareholders, supervisory personnel, or other highly compensated personnel. A wide variation is accomplished through integration, and the rationale used is that there is a "uniform relationship" between the compensation and the benefits so as to avoid discrimination even though benefits to the highly paid employees are greater. The coverage is narrow at times, for example, in a plan limited to salaried employees of a company having a few salaried executives and several hundred workers all of whom are on hourly wages.[21] It would appear that any integration would be discriminatory in practice when the usual wage scale is considered.

Plans requiring employee contributions have not been of much importance. There would be no prohibition against such a plan unless the manner of establishment of the plan or the rate of required contribution was so excessive as to be presumed to intend to discriminate against lower paid employees.[22] Contributions, where required, are usually a fixed percentage of earnings. In the flat benefit plans the rate may be an expressed amount. The contributing employee is usually guaranteed the return of his contribution together with interest in cash at termination of employment, or as a death benefit if he should die before retirement, or in the form of retirement income.

The trend appears to favor non-contributory plans. The fact that employer contributions to a qualified pension plan are deductible to the employer, while employee contributions are taxable as ordinary income to the employee, is a strong factor in the unpopularity of contributory plans. Apparently organized labor has taken a strong negative view to contribution by employees. The fact that during the past several years at least three out of every

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[19] Int. Rev. Code of 1954, § 401(a) (5).

[20] Int. Rev. Code of 1954, § 401(a) (4).

[21] *cf.* Rev. Rul. 57-163, part 4(d), 1957-1 Cum. Bull. 128, 140; Treas. Reg. § 1.401-1(b) (3), § 1.401-4 (1959).

[22] Contributions of over 6% of earnings are permissible; see note 21 *supra.*

four plans available for study have been non-contributory indicates the lack of popularity of the contributory plan.

Care must be taken that an intended non-contributory plan not be characterized as contributory. A recent case indicated that where the plan permitted a portion of a contribution to a profit sharing plan to be withdrawn each year, such portion within the control of the employee not withdrawn was considered to have been contributed and thus taxable as current income.[23]

The effect of self-employed individuals on the trend of such plans is at present unknown. Pending legislation may tend to make these plans more attractive, and wider use will crystallize the importance of such plans in the future.

RETIREMENT POLICY

Retirement age is an important factor in the area of coverage. The ideal retirement plan should provide for an employee's retirement when his usefulness is so impaired that he is no longer contributing to the progress of his company. Since this age will vary within different industries and as applied to various individuals, any age established would be relatively arbitrary. Social security legislation pointed to the general acceptance of sixty-five as a workable limit,[24] but the lowering of the age of qualification for social security benefits to sixty-two has apparently had no effect on private plans. This may be the result of private industry's desiring to utilize its experienced personnel as long as possible or, in some cases, desiring to lower the probability of participation by the possibility of attrition with advancing age. The latter consideration might be especially true in profit sharing plans.

It is difficult to determine a definite trend toward retirement or withdrawal from the labor force of personnel because of age. There has been no distinct separation between management and labor in the statistical approach to this consideration; consequently the type of occupation or industry in which the worker is employed provides a more distinct pattern indicator. Occupations in which employment has been expanding show continued, if not increased, employment of aged men,[25] while those industries which have stable or decreasing employment have shown reduced employment of aged personnel. Aged men are concentrated in farming, mana-

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23 Hicks v. U.S., 314 F.2d 180 (4th Cir. 1963); Rev. Rul. 63-180, 1963 Int. Rev. Bull. No. 34, at 7; Rothchild & Ness, "IRS Confines Hicks Case and Sanctions Deferred Compensation Choices," 19 J. Taxation 216 (1963).

24 U.S. Dept. of Labor, Private Pension Plans and Manpower Policy 32 (Bulletin No. 1359, 1963).

25 Defined as persons over the age of sixty-five.

gerial occupations and among the self-employed.[26] Unquestionably, public and private retirement plans have been a contributing factor to the withdrawal from the labor force of aging workers. The patterns may be more apparent when the distinction is made between employers who favor involuntary retirement and those who favor voluntary retirement.[27]

The employers who favor involuntary retirement usually stress as reasons for their programs the need to remove aging workers whose efficiency is decreasing and to open opportunities for promotion of younger men. Employers advocating voluntary retirement stress either the cost of involuntary retirement provisions or the inappropriateness of age as a criterion for separation. The age composition of their own work forces and the available labor supply are probably influential in disposing employers to favor or oppose involuntary retirement in their firms.[28]

Union leaders' attitudes toward involuntary retirement are also conditioned by their unions' specific needs.[29] Although most leaders usually oppose involuntary retirement in principle, union leaders in industries suffering heavy unemployment often view retirement of aged workers as an equitable way to ease the unemployment problems of their membership. Employer resistance to shorter working hours as a solution to the problem of unemployment has aggravated this situation and has led to recently invoked governmental opposition to overtime pay. When these factors are coupled with strong union pension or retirement plans, the direction is obvious.

From the point of general manpower policy, the trend in employment of aged men will depend upon the level of demand for labor. In wartime the severe limitation of manpower will induce a policy of retention of the older worker: when unemployment attains near normal levels the policy will shift to the opposite pole.

Increased longevity and the so-called "population explosion" have created dual problems to face the government and have become definite influencing factors in recent years. The high school drop-out problem has caused an increase in the pressure on the labor force from the bottom. Although there has been a marked increase in college attendance, with accompanying delay in entry

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26 *Supra* note 24, at 29. See table at page 32 for occupational breakdowns.

27 *Supra* note 24, at 35.

28 *Supra* note 24, at 33. Involuntary retirement may be automatic (required at a certain age), compulsory (discretionary with management) or flexible (administered with great latitude and with attention to the desires of the employees).

29 Bers, Union Policy and the Older Worker 74 (1957).

into the labor field, this apparently has been insufficient to balance the increased number of aging workers remaining in the labor force.

There has been continuing, increasing pressure on federal, state, and local governments to improve the lot of the retired individual. Medicare and similar programs are constantly being suggested as partial solutions to the problem of easing the financial burden of the large segment of the public not covered by private plans.[30] Although there has been an increase in social security and survivorship benefits, and recent legislation to ease the tax burden in sale of residences, retirement income credit relief,[32] liberalization of medicine and drug deductions,[33] and possible relief in the provisions dealing with care of dependents,[34] the pressures still increase.

Despite the efforts to ease the lot of the retired or aged, any opportunity for employment will usually find willing takers among those eligible for retirement benefits of one form or another. Statistics have established that in the professional, technical, managerial and sales occupations there has been an increase in the number of aged men employed.[35] There has been in the same period a corresponding drop in the employment of the aged in industrial occupations in which self-employment is common, and this notwithstanding financial opportunity for retirement.

It would be unwise to discount the effect of retirement income provided by pensions as an incentive for voluntary retirement. A survey of companies providing varying retirement policies has indicated that the need for income appears to be the principal reason for men sixty-four and older desiring to continue work after age sixty-five.[36] There has been no source of material which would indicate that plans permitting early retirement have met with general employee acceptance. Age sixty-five still appears to me the earliest acceptable retirement age without the influence of disability or unemployment.

VESTING PROVISIONS

Vesting provisions are probably the most significant of the coverage factors. The majority of plans provide that an employee may retain part or all of his accrued pension credits even though

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30 Lesser, "Pension and Other Employee Benefit Plans," in 2 Tax Revision Compendium, *supra* note 6, at 1383, 1387.

31 See Int. Rev. Code of 1954, §§ 121, 6012(c).

32 See Int. Rev. Code of 1954, § 37(a).

33 See Int. Rev. Code of 1954 § 213(b).

34 See Int. Rev. Code of 1954 § 214(a).

35 Kalish, Kellogg & Kessler, "Labor Force and Employment in 1961," 85 Monthly Labor Review 621 (1962).

36 See National Committee on the Aging, Work Attitudes at Age 65, 5 (1959).

he may terminate his employment before retirement. The extent of this vested right in the funds differs from plan to plan. Most plans establish requirements which must be met before the right to the funds becomes vested in the employee, his heirs or estate. Usually these requirements are based on either years of service or an attainment of a specified age together with the completion of a specific number of years of service. There is no specific requirement in the Internal Revenue Code that a plan contain provisions for vesting, other than the requirement that vesting must occur upon attainment of a normal retirement age.[37]

Vesting basically is intended to provide the employee with some assurance that a change of jobs will not result in the loss of acquired pension benefits. This creates a measure of security by allowing projection of the value of the acquired rights. The degree and scale of vesting is usually subject to limitation by the employer so as not to eliminate entirely a basic purpose of these plans to the employer — the reduction of turnover.

An employer must determine his turnover rate to enable himself properly to establish his plan. This provision is important because vesting is a distinct item in computing the cost of the plan. As the most important question to each individual is whether or not he will in fact get a pension upon retirement, vesting takes on major importance.[38]

Effect on Employee Mobility

Because of the degree of employee mobility that has characterized our economy, the requirements of service and age may not be met by a large number of those currently employed and participating in the pension plan. The problems to be considered then are: have deferred vesting requirements limited or deterred the natural mobility of labor, and further, is such a deterrent desirable and acceptable, considering its probable expense to the individual worker?

The problem is thus reduced to the conflict between the desirability of employees obtaining pensions upon retirement and the desirability of workers feeling free to change jobs. This problem has brought about a trend in recent years toward a liberalization of vesting provisions or at least a creation of schedules

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37 Rev. Rul. 57-163, part 5(b) (2), 1957-1 Cum. Bull. 128-1, 147.

38 Professor Dan M. McGill concluded, "Reference to available turnover statistics suggests that possibly no more than 40 per cent and certainly no more than 50 per cent of employees presently covered under private pension plans will ever receive a cash benefit from the plan." Pensions: Problems and Trends (McGill ed. 1955).

where none previously existed.[39] The labor unions have strongly advocated greater flexibility and employee mobility without loss of pension rights, and this has resulted in the industry-wide plans and the geographical multi-employer plans.[40] In the area plans, those which cover all union members within a given geographical area, termination does not affect the member's participation in the plan as long as he is employed by a participating employer.

The problems of labor mobility and its effect on the overall manpower policy of our government have caused sufficient concern to require careful investigation. In 1961 approximately one-tenth of the workers employed during that year changed jobs.[41] The volume of such job changes may certainly be considered an indicator of economic conditions. In considering the factors surrounding job changes one must examine average employee age, length of service, occupation and industry in coming to a reliable conclusion.

An examination of age as a criterion reveals the largest group changing jobs in a given year was between the ages of eighteen to twenty-four.[42] This is understandable, since the younger worker has little to lose in the way of seniority or pension rights in a job change; therefore he will change positions until he finds a job which suits him. The number of jobs left voluntarily by workers decreases rapidly with age. This fact is one of the most firmly established findings of the research in this area. Apparently a worker who has become established with a firm and satisfied with his job considers the security which accumulated seniority provides, together with other fringe benefits, sufficiently important to overcome any desire for a change in jobs. Difficulty in finding adequate employment with advancing age would also be a contributing factor. This does not mean that some workers do not retain a degree of mobility throughout their lives;[43] it must be noted, however, that such workers customarily hold jobs for periods of short duration.

In establishing any trend in labor mobility it is necessary to consider the changes in national economic conditions, because the rate of change appears to be greater during periods of prosperity.[44]

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39 Bankers Trust Company, Studies in Industrial Pension Plans (1956 and 1950 editions).

40 *Supra* note 24, at 5.

41 *Supra* note 24, at 6.

42 *Supra* note 24, at 7, table 2.2, "Number of jobs left per 100 persons who worked during 1961, by reason for leaving job, age, and sex."

43 Bureau of Old Age and Survivor Insurance, Division of Programs Analysis, Incidence of Employee Change," (Analytical Note 80, April 18, 1956.)

44 *Supra* note 24, at 10.

Employee mobility surveys are generally limited to the manufacturing industries because accurate figures can be most readily obtained in these industries. There appears to be a gradual general decline in the "quit rate" of employees. It is often explained in terms of the following influences: growth of unions, development of seniority provisions, development of fringe benefits (especially pensions), government and supplementary unemployment benefits, growth of large corporations, aging of the labor force, and stability of manufacturing employment. It would be impossible to attribute the general decline of employee mobility to any one of these factors.[45] If it were possible to choose the most influential factors, one would probably have to accept the development of fringe benefits and aging of the labor force as the most important since the other forces were prevalent both during World War II and thereafter, before the decline became marked. Although one hesitates to place primary emphasis on pensions, many writers have asserted that pensions do reduce mobility independently of other influences.[46] These conclusions have been drawn despite the lack of data on this subject.

Consideration should be given to the three recent developments in pension plans which may have had a significant effect upon the mobility of the employees: first, early vesting has become more common; second, early retirement and disability retirement are being provided in an increasing number of plans; and, third, collective bargaining multi-employer plans are more common.

The number of pension plans containing vesting privileges has grown from one-fourth of a 300 plan study by the Bureau of Labor Statistics in 1952 to six-tenths in 1958.[47] Daniel M. Holland[48] pointed out that statistics accumulated by Bankers Trust Company[49] indicate the increasing liberality of the plans created in recent years to those workers employed for ten or more years.

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[45] See Shister, "Labor Mobility: Some Institutional Aspects" in Industrial Relations Research Association Proceeding (1950); Brissenden, "Labor Mobility and Employee Benefits," 6 Lab. L.J. 762 (1955).

[46] Kerr, "Social and Economic Consequences of the Pension Drive," in Handbook on Pensions (National Industrial Conference Board, Inc., Studies in Personal Policy No. 103, 1950) where the author observes, "Private pension plans, except where they provide full and immediate vesting of both the employee's and firm's contribution, retard such movement. They tend to tie the worker to the company while employed; and hold him in a company-attached labor pool when unemployed.' Tilove, *op. cit. supra* note 9, came to a like conclusion.

[47] Bureau of Labor Statistics, "Pension Plans Under Collective Bargaining,' (Bulletin No. 1259 at 21, 1959).

[48] *Op. cit. supra* note 6.

[49] Bankers Trust Company, A Study of Industrial Retirement Plans 14 (1956)

In the 1958 study, 218 of the 300 plans included provisions for early retirement.[50] Probably the only noticeable effect of these provisions is to hold workers approaching the early retirement age until they have attained this mode of vesting.[51] In effect it may only serve to permit older workers to seek lighter work without actually retiring them from the labor pool. Thus to some degree, this factor will not, in reality, serve to reduce mobility, but may even act to stimulate the older semi-retired worker to seek the change he may have long desired.

The significance of the growth of multi-employer plans is questionable. These plans usually cover one trade in a number of localized industries, although in some cases such plans cover all workers in one industry nationally. No matter what the form of the plan, one result is to permit a worker to change jobs within the industry.[52]

It can therefore be generally concluded that pension plans have had no appreciable effect on worker mobility and there is no indicated trend of limitation of mobility among younger employees by a promise of future vesting unless such vesting would occur almost immediately. From an employer's point of view early vesting would be most desirable in holding down costs if it reduced employee turnover and reduced costs of training and funding. This early vesting need not mean vesting of all benefits, but some vesting would appear to place a premium on retention of employment without placing an undue restraint on mobility.

An Agenda for Inquiry

After considering the various aspects of pension plans, a critical view for the purpose of suggesting corrections for some shortcomings is appropriate. A selection of some of the major problems will be discussed.

Corporate Rules on Integration

By the provisions of the Internal Revenue Code of 1954,[53] employee benefits are permitted to be integrated with Social Security coverage. By integration the code implies that the amount of the pension to be given any employee is interrelated with the

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[50] *Supra* note 47, at 11.

[51] The Internal Revenue Service has ruled that one hundred per cent vesting is required when employee consent is a requirement for early retirement. Rev. Rul. 57-163, *supra* note 21.

[52] Bureau of Labor Statistics, "Multi-employer Pension Plans Under Collective Bargaining," (Bulletin No. 1326, 1962).

[53] Int. Rev. Code of 1954, § 401(d)(6)(B).

Social Security payments to be received by the employee upon his retirement. The only limitation set out in the application of this principle is that in situations covered by the Self-Employed Individuals Tax Retirement Act of 1962,[54] owner employee contributions may not exceed one-third of the total contributions. In practice this will prevent the adoption of an integrated plan by professional men unless their firm has a sufficient number of partners so that each partner has less than a ten per cent interest. It would appear that the intent of this provision is to eliminate the situations in the usual corporate plan in which integration is used to exclude from benefits any employee earning less than $4,800 dollars.[55] In situations where this limitation would be onerous, steps can be taken to circumvent the added cost of this requirement, such as operation of the office through another entity, paying appropriate amounts for services provided, leaving the professional to individual practice. This possibility is not desirable, but it is a likely outgrowth of the narrow limits of these plans. The larger firm is not burdened by this necessity because where the number of participants exceeds ten, the firm may avail itself of the normal corporate plan benefits.[56] This statutory attempt to limit discrimination is in fact discriminatory. It sets up a completely different set of rules from those applicable to ordinary corporate plans. In those plans the provisions of section 401(a)(5) concerning integration with Social Security completely dilute the provisions of section 401(a)(4) against discrimination with respect to contributions or benefits. The formulas under which the commissioner has acquiesced to this form of discrimination have been set out in Internal Revenue Mimeo, No. 6641.[57] It should be pointed out that integration is not required by the Code: it is a requirement added by the Treasury in interpreting the kind of discrimination that is permissible under the Code.

What would seem to be needed in this area is a complete revision of this part of the Code, dispensing with classes of plans and establishing one set of criteria enunciated in the Code and not in the regulations.

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[54] 76 Stat. 809 (1962).

[55] The professional is required to extend the benefits of coverage to his secretary, receptionist, nurse or other employee who has more than three years service.

[56] Adams, "Retirement Plans for Self-Employed Lawyers," 17 Record of N.Y.C.B.A. 528 (1962); see also Int. Rev. Code of 1954, § 401(d)(5)(A), (B); 404(e)(1) (2).

[57] 1951-1 Cum. Bull. 41, as modified by Rev. Rul. 61-75, 1961-1 Cum. Bull. 140; see also Treas. Reg. § 1.401-3(e)(2)(1960).

The Estate Tax Exclusion

The availability of the estate tax exclusion when distribution of vested benefits is postponed beyond normal or stated retirement age deserves investigation. Upon retirement the employee will often have the option of determining the mode of receipt of his vested rights. This is done by electing to take all vested benefits in a lump sum[58] or in installments from some source, either the plan itself or an annuity based on a conversion of rights under the plan.[59]

In many instances corporate executives may arrange with the company to remain active or to defer by other means receipt of retirement or pension benefits to some date beyond the normal or stated retirement age in the plan.[60] When this occurs and the employee dies before the vested interests are to be distributed, the benefits are then distributed directly to a named residual beneficiary without inclusion in the estate of the deceased, thus avoiding estate taxes.[61] This possibility is somewhat avoided in plans for the self-employed due to the policy of placing a maximum age of seventy before receipt is required.[62]

Although this situation is no different from that which exists in the case of the employee who dies prior to having achieved the stated or normal retirement age, it does give the surviving employee a great deal of control over the handling of these funds. It is, however, not the usual situation: it would not normally be available to all employees. It would tend to grant a further benefit to the executive or employee-stockholder who would be in a position to bargain for such a benefit. This possibility of the transfer of the retirement program free of estate taxes is of value in estate planning and in itself is not to be deplored. What is disturbing is the ability to postpone and avoid these taxes by the deferment of the vested benefits past the normal or stated age in the plan, and the fact that such deferment will not be universally permitted. This again disturbs the equality in the application of the tax laws.

This situation may be remedied by expansion to cover all

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58 Such benefits are taxed at capital gains rates under Int. Rev. Code of 1954, § 403(a)(2).

59 Taxable at ordinary income rates, annuities being taxed under Int. Rev. Code of 1954, § 72(a).

60 Permissible under Rev. Rul. 61-157, part 5(j), 1961-2 Cum. Bull. 67, 91.

61 Int. Rev. Code of 1954, § 2039(c). This enables the avoidance of the "made available" provisions of Treas. Reg. § 20.2039-2(b)(3), example 4 (1958) as amended in T.D. 6526, 1961-1 Cum. Bull. 402, 407.

62 Int. Rev. Code of 1954, § 401(a)(9)(A).

persons or a contraction to prevent the deferment where it benefits only a few. Practical equalization would probably require contraction, for few run-of-the-mill employees can afford to postpone their pensions should they survive beyond the retirement age and be forced to retire.

Capital Gains Treatment of Multiple Taxpayers

There is a possibility of having the capital gains rate apply when multiple taxpayers are beneficiaries so as to ameliorate the income-bunching effect of a lump sum distribution. The primary benefit of the deferred compensation plans is the deferral of income tax until the actual receipt of the income.[63] The method of payment chosen by the taxpayer-beneficiary will determine the character of the tax imposed. In some instances the plan leaves this determination to the discretion of the trustee[64] with such discretion being applied to each individual case as it arises.

If the lump sum payment method is chosen, then under section 402(a)(2) capital gains treatment results.[65] If periodic payments are made, the annuity rules of section 72 apply and the ordinary income tax rates are used.[66] Different tax advantages are available by effective use of these alternative methods.

The installment method may result in a lower total tax even though ordinary tax rates apply and income-bunching does not occur. (Bunching is defined as receipt of all income in one taxable year.) Some taxpayers will be better off to suffer bunching in order to obtain the benefit of capital gains rates. These possibilities have required that careful consideration be given to the projection of income over the future years.

There are, however, several ameliorations to the bunching effect which have been clearly established by the Treasury.[67] This effect can be avoided in some instances where the lump sum distribution is divided among a number of distributees. As each distributee is an individual taxpayer, each would receive the benefits of capital gains treatment provided each one had the same taxable year.[68] A trust could be created among the bene-

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63 Int. Rev. Code of 1954, § 402(a)(1), (2).

64 Rev. Rul. 61-157, part 5(n), 1961-2 Cum. Bull. 67, 93.

65 Subject to possible limitations established by Internal Revenue Mimeo. No. 5717, 1944-1 Cum. Bull. 321, as modified by Rev. Rul. 60-10, 1961-1 Cum. Bull. 143.

66 See also the provisions of the Int. Rev. Code of 1954 § 402(a)(1) and Grayck, "Taxation of Distributions from Qualified Pension and Profit Sharing Plans," 39 Taxes 34 (1961).

67 Rev. Rul. 62-190, 1962-2 Cum. Bull. 130; Rev. Rul. 292, 1960-2 Cum. Bull. 153.

68 Treas. Reg. § 1.402(a)-1(a)(6)(iv) (1963).

ficiaries of the distribution and would be entitled to a lump sum or capital gain treatment.[69]

This situation would seem to be an approved means of circumventing the uniform application of the law. It could even be more classically applied where the taxpayer could effectively be an employee of numerous corporations over a period of years and have vested interests in all of them, being able to defer the receipt of the benefits to a year of his choice and then receive the benefits in such a manner as to have the receipts taxable in succeeding years. Although this possibility would seem to be remote, it is a possible extension of the present Treasury rulings. A multiple taxpayer method would be effective in the case of a deceased employee who had been able to allocate his vested rights by testamentary or inter vivos determination to which the trustee had acquiesced or agreed to accept in advance.

Plan Termination

The possibility of termination of a benefit oriented plan without restriction on benefits to management employees after ten years of operation of the plan presents some opportunity for abuse. The Treasury Department has established the existence of a plan for a term of ten years as sufficient to negate a presumption of discrimination in receipts of benefits and the resultant reallocation among lower-paid employees when a plan is terminated.[70] The executive group often has the ability to control the progress of the company or to act in a manner designed to create situations to avoid characterization of plan termination as discriminatory.[71] Where such executive control exists, the distributions on termination can create benefits to the executive group, generally to the detriment of the remaining employees and those employees discharged during the period preceding termination. This situation, in addition to the relative transience of lower paid employees, has permitted executive groups to reap the greater share of benefits from pension and profit sharing plans.[72] It is especially effective in closely held corporations.

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69 Rev. Rul. 58-423, 1958-2 Cum. Bull. 151.

70 Mimeo 5717, *supra* note 65.

71 See Bernstein, "Employee Pension Rights When Plants Shut Down: Problems and Some Proposals," 76 Harv. L. Rev. 952 (1963).

72 Pension plans with past service funding and profit sharing plans with reallocation of the forfeitures. The factual situation in Ryan School Retirement Trust, 24 T.C. 127 (1955) is an excellent example. Here the plan at its initiation had five officers and supervisory employees and one hundred fifteen rank-and-file employees. Within one year one hundred ten employees had been terminated or transferred. When the plan was terminated some six years later there were ten employees of whom five were officers. Only three were rank-and-file employees who had been with the plan from its inception.

A basic control against the abuse of termination provisions would be an affirmative requirement that the company establish its inability to continue with the plan on a permanent basis. Some effort has been made to correct the possibility of abuse in the 1962 act [75] by the provision 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 discontinuance, to the extent then funded, or the amounts credited to the employees' accounts, are non-forfeitable." This section of the Code was buttressed by regulations.[76] The discharge, on a large scale, of employees during the winding up of the business is considered to be a termination.[77] The regulations restate that "whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case." [78]

Basically the Code provides that no portion of the contributions are to be diverted to the founding corporation's uses.[79] However, there would be no objection under the Code to funds being returned to the employer if, upon termination, because of previous separations there was an excess of moneys above that required to pay benefits due the remaining covered employees. This excess would be deemed to arise from erroneous actuarial determinations.[80] Apparently many plans contain a provision permitting such recoveries.[81]

In the instance where a plan is terminated in its early years without a complete past service funding, there may be little returned to the employer, the majority of the proceeds going to the remaining executive group. Such a situation was unsuccessfully attacked by the Treasury as discrimination.[82]

A weaker position is found in the area of permanent discontinuance [83] than that which obtains in temporary cessation or suspension of contributions. The regulations are vague. The suspension rule tends to operate as a test of the ultimate result. To

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73 Int. Rev. Code of 1954, § 346.

74 Int. Rev. Code of 1954, § 531.

75 See Int. Rev. Code of 1954, § 401(a)(7).

76 Treas. Reg. § 1.401-6 (1963).

77 Treas. Reg. § 1.401-6(b)(1) (1963).

78 *Ibid.*

79 Int. Rev. Code of 1954, § 401(a)(2).

80 Treas. Reg. § 1.401-2(b)(1) (1963).

81 Bernstein, "Tax Regulation of Private Pension Plans: Some Problems and Proposals," 10 U.C.L.A. L. Rev. 808, 819 (1963).

82 Ryan School Case, *supra* note 72; see the formulas established in Treas. Reg. § 1.401-6(c) as to past service funds use.

83 Treas. Reg. § 1.401-6(c)(1) (1963).

constitute a suspension the plan must fail during any taxable year to meet the benefit claims upon it and also fail to have on hand investments, funds or paid-up annuities equal in value to no less than the interest charges on the original unfunded past service credit cost. The result is that past funding could be borrowed to avoid the plan's termination. Thus, during the period of separation of the employees, no contributions would necessarily have to be made, provided no prohibited result occurred.

This situation leaves a wide area of possible abuse, especially in those plans where there is no vesting until retirement or termination. The present suspension rules are highly inadequate to protect employees. Perhaps amendment to provide that failure to make the necessary contribution shall require immediate vesting in the currently employed persons covered by the plan, at least to the extent of past contributions on their behalf, would provide more protection. Such a provision would necessarily require companies to be more cautious in estimating their ability to fulfill the plan and would prevent the feeling that subsequent weakening of the company's position would still permit the executives to reap full benefits. This provision would prove most effective in close corporation situations.

Such weakness in the area of termination-vesting must be strengthened in another manner. Permitting low-level funding by projection of turnover rates or funding for the payment of claims of the older management group with the subsequent termination of a plan so as to provide the greater share of funding to this segment of the employees [84] is a basic weakness which requires correction. Further, the regulations permit too great an impairment of past service funding by permitting borrowing to avoid suspension.[85]

Lump Sum Distributions

The desirability of the use of capital gains treatment to lump sum distributions raises purposive questions. One question would be whether distribution of pension funds *should* be given a capital gains treatment. The funds invested in the non-contributory plan are not those of the individual taxpayer. All he has invested is his time with the company as an employee, for which he has

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[84] It is this situation within ten years of forming the plan that Mimeo 5717, *supra* note 65, attempts to eliminate; but what of termination ten years and one day later, a possibility within the Board of Directors' ability to control? See also Rev. Rul. 61-157 part 5(c)(2), 1961-2 Cum. Bull. 67, 88, and Mimeo 5717, 1944-1 Cum. Bull. 321, as modified by Rev. Rul. 61-10, 1961-1 Cum. Bull. 143, which is incorporated in Rev. Rul. 61-157, part 5(c)(2), 1961-2 Cum. Bull. 67, 88.

[85] Treas. Reg. § 1.401-6(c) (1963).

supposedly been adequately compensated. It may further be questioned whether the employee would have received greater compensation directly in the absence of such a deferred compensation plan. To a great degree the answer would be no; for example, omission of the negotiated union plans would not necessarily have meant greater current earnings to beneficiaries. If greater earnings did result, such earnings in any given year would be negligible. It is the gross effect of these accumulations with their accompanying tax free treatment of the income from the investments that is the factor involved. This is true even in the case of the highly compensated executive. Additional income to a high bracket taxpayer is of little value. It should be determined as part of this consideration whether the plans are in reality intended to create benefits for retirement or are simply schemes to defer taxes.

If the intent is to lighten the load during retirement years or to induce earlier retirement by providing adequate resources to draw upon, then the concept of lump sum benefit and its accompanying capital gains treatment is foreign and should be rejected. It would appear to be more compatible with such purposes to have the funds with a trustee or in an annuity rather than in the hands of the employee, who must reinvest the funds, possibly without the necessary skill. Since the benefits are intended to supplement Social Security, they should be received in the same manner and concurrently with Social Security payments.

This approach was taken in the Self-Employed Retirement Act.[86] The self-employed person is denied the benefits allowed taxpayers employed by corporations. Although there is a compromise of sorts which permits some protection from graduated tax rates,[87] there is still an inconsistency which borders on discrimination without logical purpose.

Nondiscrimination

The present inconsistent requirements in the Code that corporate plans be nondiscriminatory as to coverage, contributions, or benefits are coupled with gaping loopholes. The Internal Revenue Code provides certain standards which must be met for qualification of a plan as nondiscriminatory in favor of officers, shareholders, supervisory and other highly compensated employees. The plan may not be limited in coverage to such managerial employees, and the Code provides a statutory formula that would deny qualification if less than fifty-six per cent of "all the employees" [88] par-

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[86] *Supra* note 54.

[87] Int. Rev. Code of 1954, § 72(m) (1), (2).

[88] As defined by Int. Rev. Code of 1954, § 401(a) (3) (A).

ticipate. Of course the employer may obtain approval without meeting this coverage requirement if he can prove to the Commissioner's satisfaction that the coverage is not in fact discriminatory.[89] Alternatively, the plan must not be discriminatory as to contributions or benefits.[90] It is not required that *both* contributions and benefits be nondiscriminatory.

The size of contributions or benefits under a qualified plan is not limited either to a percentage or dollar amount of the portion of the total or annual contributions that can be allocated for management employees.[91] All that is required is that the contributions bear a uniform relationship to the annual compensation of the employee.[92] This factor is also present to a larger degree in benefit plans, because managerial employees usually have a longer term of service than do rank-and-file employees.[93] The only limitation on these plans is that against early termination.[94]

Further obvious discrimination is found in the ability to integrate the plans with Social Security benefits.[95] This is attempted to be justified on the ground that the employer is required to contribute to the plan.[96] Unfortunately this in effect turns what is normally considered to be a noncontributory plan into a contributory plan because the employee is required to pay a like amount.[97] This situation permits only those employees who earn in excess of 4,800 dollars to receive the total benefits of a plan. This example points out the inconsistencies of the Code itself, for it provides the basic means to circumvent its built-in safeguards.

Postponed Vesting

The present freedom of corporate plans to postpone vesting until normal or stated retirement age is attained may be regarded

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89 Limited as to discrimination in Treas. Reg. § 1.401-4, which now implies that the matter of disproportionate contributions will be extended beyond the first 10 years of the plan. It is no longer limited to plans which terminate, but rather places a ceiling upon benefits to any but the highest paid employees which can be raised only so long as full current costs plus interest on the unfunded liability is met. There is a question as to the strength of this regulation in light of the thinking in Ryan School, *supra* note 72, and Volckening, *infra* note 91.

90 *Id.* See also Int. Rev. Code of 1954, § 401(a)(4).

91 Volckening, Inc., 13 T.C. 723 (1949), stated that there was no statutory basis for such a limitation.

92 Goodman, "Permanency as a Requisite of Tax Qualified Pension and Profit Sharing Plans," 39 Taxes 42, 46 (1961).

93 *Cf.* Rev. Rul. 60, 1955-1 Cum. Bull. 37.

94 Mimeo 5717, *supra* note 65; Treas. Reg. § 1.401-4(c) (1963).

95 Int. Rev. Code of 1954, § 401(a)(5).

96 Int. Rev. Code of 1954, § 3111(2).

97 Int. Rev. Code of 1954 § 3101(b).

as liberty or license. There is no statutory requirement for vesting the benefits as the Code applies to the usual corporate plan. This requirement only appears in the self-employed individuals' plans, and there the requirement is for immediate vesting.[98] The corporate plans may run the gamut from immediate and complete vesting to no vesting until retirement age is reached. The facts in each particular case determine whether the vesting provisions are satisfactory.[99] This freedom of the employer to establish vesting levels at the time the plan is established acts primarily to benefit those employees who remain with the company for the longest period of service, especially in the case of profit-sharing plans,[100] and this group is usually the executive or shareholder group.

Union negotiated plans have somewhat overcome this problem by the use of industry-wide or area plans. Notwithstanding this major item of progress there is still much to be done to alleviate the practical inequities implicit in greatly delayed vesting. Statutory change appears to be the only answer.

The Professional Corporation

The effect of the professional corporation upon the area of deferred compensation has been much debated. The background of the problem has been the attempt of the Treasury to limit the relevant court decisions.[101] It became apparent that it would be difficult for any group to meet the criteria outlined by the Treasury because of existing state laws; participation by an individual was, of course, impossible. A movement in state legislatures to broaden possible professional use of deferred compensation plans resulted in the passage of different forms of legislation. Authorities have taken opposite positions as to the validity of the legislation.[102] Until recently the Treasury has refused to rule on the submitted plans.

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98 Int. Rev. Code of 1954, § 401(d)(2)(A).

99 Treas. Reg. § 1.401-1(b)(1)(i) (1963).

100 See Rev. Rul. 61-157, part 5(d), 1961-2 Cum. Bull. 67, 88, which provides that, since benefits of profit sharing plans are not determinable, the forfeitures may be allocated among the remaining participants on a nondiscriminatory basis.

101 U.S. v. Kintner, 216 F.2d 418 (9th Cir. 1954); Treas. Reg. §§ 301.7701-1 to 11 (1960) outline the criteria for approval. See also Lyons, "Comments on the New Regulations on Associations," 16 Tax L. Rev. 441, 444 (1961).

102 Bittker, "Professional Associations and Federal Income Taxation; Some Questions and Comments," 17 Tax L. Rev. 1, 28 (1961) takes a negative position. Grayck, "Professional Associations and the Kitner Regulations: Some Answers, More Questions and Further Comments," 17 Tax L. Rev. 469 (1962) takes the opposite position.

The proposed regulations[103] concerning such plans followed the expected pattern and are certain to lead to litigation due to the narrow view taken by the Treasury.

The Treasury's approach has been to limit the extension of the benefits of deferred compensation rather than to correct the inequities by limitations of general applicability to participation. It is true that Congress has not been cooperative in its view of a general cutback despite the abuses which have grown about the present statutory operation.

Conclusion

The entire area of deferred compensation has become a battlefield due to inconsistencies of purpose and effect which exist. The Commissioner has not always been strict in the application of the Code. Often the apparent softness has been caused by court decisions which the Treasury has been forced to accept. It has been hoped that the passage of the H. R. 10 legislation would alleviate the problem to some degree, because the House Reports[104] described the legislation as giving "self-employed persons access to retirement plans on a reasonably similar basis to that accorded corporate stockholder employees." Instead of this result, the bill proved a narrow and shadowy image of that which governs the corporate employee. It is true that the act applies many corrective measures to the self-employed to limit the abuses which the Treasury desired to be applied to all plans, but the bill went no further. It is to the credit of the Treasury that most of the provisions of the current act were proposed by the Treasury at hearings before the Senate.[105] These were intended to affect all employees who owned ten per cent or more of the voting stock of a corporation.

It may be felt that the current situation is a step toward tax reform and that the corporate statutes should be amended instead of liberalizing the self-employed provisions.[106] It is ob-

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103 Proposed Treas. Reg. §§ 301.7701-1, 301.7701-2, 28 Fed. Reg. 13750 (1963) have even reversed the earlier ruling contained in Letter From John W. S. Littlton, Director, Tax Ruling Division, Commissioner of Internal Revenue, to Reid and Riege, Hartford, Connecticut, March 2, 1961, reprinted in P-H Pension and Profit Sharing ¶ 11,979; see also Grayck, "Tax Qualified Retirement Plans for Professional Practitioners: A Comparison of the Self-Employed Individual Tax Retirement Act of 1962 and the Professional Association," 63 Col. L. Rev. 414 (1963).

104 H. R. Rep. No. 139, 87th Cong., 1st Sess. 2 (1961).

105 Hearings on Pension Plans for Owner-Managers of Corporations Before the Senate Committee on Finance, 86th Cong., 2nd Sess. 5 (1960).

106 Phillips, "More on H.R. 10," State Bar Bulletin of New Mexico (Jan. 1, 1963).

vious, however, that the average self-employed individual will have to attempt to discover means of circumventing the difficult areas of the bill.[107] Neither is a satisfactory result. More investigation of the possibilities of complete revision appears to be the answer.

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107 Hobbet & Donaldson, "H.R. 10; Many Opportunities Exist for Minimizing Restrictions of New Rules," 17 J. Taxation 339 (1962).