

Cleveland State University  
**EngagedScholarship@CSU**



**Cleveland-Marshall**  
College of Law Library

---

Cleveland State Law Review

Law Journals

---

1969

# Retirement Plans Limited to Salaried Employees: Tax Advantages and Qualification

Gerrit C. Kuechle

Follow this and additional works at: <https://engagedscholarship.csuohio.edu/clevstrev>

 Part of the [Retirement Security Law Commons](#), and the [Taxation-Federal Commons](#)

**How does access to this work benefit you? Let us know!**

---

## Recommended Citation

Gerrit C. Kuechle, Retirement Plans Limited to Salaried Employees: Tax Advantages and Qualification, 18 Clev.-Marshall L. Rev. 413 (1969)

This Article is brought to you for free and open access by the Law Journals at EngagedScholarship@CSU. It has been accepted for inclusion in Cleveland State Law Review by an authorized editor of EngagedScholarship@CSU. For more information, please contact [library.es@csuohio.edu](mailto:library.es@csuohio.edu).

## *Retirement Plans Limited to Salaried Employees: Tax Advantages and Qualification*

Gerrit C. Kuechle\*

PRIVATE RETIREMENT PLANS<sup>1</sup> have assumed tremendous importance to both the employer and the employee in our modern American economy.<sup>2</sup> Of particular interest are the tax advantages granted to such plans and the requirements necessary to qualify for such favored treatment.<sup>3</sup> Retirement plans are among the most effective tax saving devices available<sup>4</sup> and can be extremely attractive, as will be shown, to the small corporation and the highly compensated employee, especially when it is considered that a properly designed plan can be integrated with Social Security so that larger benefits are provided on the salary in excess of that covered by Social Security than on the salary subject to Social Security.<sup>5</sup>

So important have private retirement plans become in our society, that in 1962 President Kennedy appointed a Cabinet level committee to study such plans. In its report, the Committee stated that private pension plans presently cover approximately half of the private non-farm labor force in the United States, or roughly 25 million workers, and that reserves of these plans, which stood at 12 billion dollars in 1950, are expected to rise to 225 billion dollars by 1980.<sup>6</sup> Internal Revenue Service statistics show that the number of plans which it has examined and found to qualify for favorable tax treatment jumped from approximately 10,000 at the end of 1947 to more than 151,000 by the end of 1967, and that each year the number of new plans approved is greater than the year before, with more than 19,000 new plans approved in 1967 alone.<sup>7</sup>

Most authorities agree that a number of factors have been responsible for this remarkable growth. Certainly an important factor has been the underlying demand of employees for security in retirement,

---

\* B.A., Beloit College; Pension consultant and administrator in the Cleveland office of National Associates, Inc., Employee Benefit Plan Consultants; Fourth-year student at Cleveland-Marshall Law School.

<sup>1</sup> In this paper the terms "retirement plan" or "plan" will be used to indicate both pension and deferred profit sharing plans unless otherwise indicated.

<sup>2</sup> President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, Public Policy and Private Pension Programs 18-19 (1965) (Hereinafter cited as President's Comm. Report).

<sup>3</sup> *Ibid.* at 15-19.

<sup>4</sup> Hinckley, *Employee Classifications in Qualified Plans*, 22-3 J. Am. Soc. C.L.U. 45 (1968).

<sup>5</sup> Int. Rev. Code of 1954, § 401(a) (5); Treas. Regs. § 1.401-3(e) (1954).

<sup>6</sup> President's Comm. Report, *supra* note 2, at 10.

<sup>7</sup> P-H Pension & Profit Sharing Serv. ¶ 15,002.

especially as this has been promoted by organized labor.<sup>8</sup> Another has been management's receptiveness to retirement plans, particularly plans that cover key employees.<sup>9</sup> Reinforcing these has been a third major factor, that of the Federal Government as manifested through judicial decisions;<sup>10</sup> administrative rulings and reports; and legislation including the various Social Security Acts, and especially the Internal Revenue Code and the tax incentives contained therein.<sup>11</sup>

Plans limited to salaried or clerical employees were among the first to be established in the United States and in 1963 constituted approximately one-quarter of all private retirement plans, accounting for roughly 10% of the employees covered by plans.<sup>12</sup> Recently there has been an increased interest in salaried-only plans. This can be attributed to several factors; retirement plans have proven to be an effective method of attracting and holding highly compensated, key employees, for whom the tax advantages of a plan are important;<sup>13</sup> many small employers cannot afford a plan that would encompass all employees but feel that a plan should be provided for at least one segment of employees; many employers want to provide a different type of plan or funding for salaried employees; and many employers have negotiated or will have to negotiate a plan for employees who are members of a union.<sup>14</sup>

### Tax Advantages

The tax advantages inherent in a retirement plan limited to salaried employees are exactly the same as those which are enjoyed by any other retirement plan which has been approved by the Internal Revenue Service, although the high bracket individual may appreciate the tax break more than some other employee.<sup>15</sup> Briefly summarized, the tax advantages in the Code are: (1) employer contributions to a plan are generally deductible as a business expense;<sup>16</sup> (2) employer contributions

<sup>8</sup> D. McGill, *Fundamentals of Private Pensions*, 29 (2d ed. 1964); Report of the President's Cabinet Committee on Private Pension Plan Regulation: An Appraisal, 63 Mich. L. Rev. 1258 (1965).

<sup>9</sup> President's Comm. Report, *supra* note 2, at vi; McGill, *supra* note 8, at 21-23.

<sup>10</sup> *Inland Steel Co. v. NLRB*, 170 F.2d 247 (7th Cir. 1948), cert. denied, 336 U.S. 960 (1948).

<sup>11</sup> President's Comm. Report, *supra* note 2, at 12-13; McGill, *supra* note 8 at 23-28.

<sup>12</sup> U.S. Bureau of Labor Statistics, Dept. of Labor, Bull. No. 1407, *Labor Mobility and Private Pension Plans*, 8 (1964); see Appendix A.

<sup>13</sup> McGill, *supra* note 8, at 23.

<sup>14</sup> Hinkley, *supra* note 4, at 45.

<sup>15</sup> For two articles on this subject by the Chief of the Pension Trust Branch of the Internal Revenue Service see, Goodman, *Taxation of Distributions to Employees under Qualified Plans: When and How Much*, 24 J. Taxation 14 (1966), and *How to Obtain Capital Gain Treatment on Distributions from Qualified Plans*, 24 J. Taxation 76 (1966).

<sup>16</sup> Int. Rev. Code of 1954, § 404 (a).

are not includable as taxable income for the employee until actually received by him;<sup>17</sup> (3) earnings accumulated on funds held are free of tax until distributed;<sup>18</sup> (4) up to \$5,000. of death benefits, if paid as a lump sum, are not taxable income;<sup>19</sup> (5) distributions attributable to employer contributions which are paid within one year of termination of employment or death are eligible for long-term capital gains treatment;<sup>20</sup> (6) payments upon death of a participant which are attributable to employer contributions are free from estate<sup>21</sup> and gift tax;<sup>22</sup> and (7) unrealized appreciation on employer securities included in a distribution eligible for capital gains treatment is excluded as taxable income.<sup>23</sup> In the words of the President's Committee, "it is evident that the tax advantages for both employers and workers are very significant."<sup>24</sup>

This is one of the few places where the Code permits a taxpayer to take a deduction without requiring another to report income. The advantage of an immediate deduction coupled with deferred reporting of income is in line with the desire on the part of most highly compensated individuals to defer some of their income to a time when their earnings will be lower, and becomes especially attractive if, at the time of receipt, capital gains rates are available. Since the employer's contributions to the plan are before taxes, and accumulate tax free, a much larger accumulation will result than if the contributions had been paid as taxable income. The estate tax exclusion of death proceeds can be an extremely useful estate planning device for the key employee, and particularly for the owner of a closely held corporation who may well face liquidity problems when it is time to pay Federal Estate Taxes.

### A Typical Salaried-Only Plan

Although each specific situation should have a plan tailor made to meet the objectives of that particular employer, a typical salaried-only plan can be illustrated. According to a Bureau of Labor Statistics' study of such plans—

It would appear that, as against production worker plans, salaried employee plans tend to provide a greater range of benefits (early retirement, vesting, death benefits) and higher benefit levels for the same earnings and service levels. Salaried employee plans more frequently provide for employee contributions, which may account

<sup>17</sup> *Ibid.* §§ 402 (a) (1), 403 (a) (1).

<sup>18</sup> *Id.* § 501 (a).

<sup>19</sup> *Id.* §§ 402 (a) (2), 403 (a) (2).

<sup>20</sup> *Id.* §§ 402 (a) (2), 403 (a) (2).

<sup>21</sup> *Id.* § 2039 (c).

<sup>22</sup> *Id.* § 2517 (a).

<sup>23</sup> *Id.* § 402 (a) (1) and (2).

<sup>24</sup> President's Comm. Report, *supra* note 2, at 17.

in part at least for the above advantages. They also tend to stipulate more restrictive participation requirements and more frequently provide for involuntary retirement.<sup>25</sup>

The study of salaried-only plans further pointed out that in the median the plan benefits, when added to the worker's primary Social Security, would provide a retirement income of somewhat more than half the worker's pay immediately prior to retirement.<sup>26</sup>

Keeping the foregoing in mind, a typical salaried-only plan can be illustrated, assuming a corporation with 104 employees, 85 of whom are paid hourly and therefore not eligible to participate, and 19 of whom are salaried. The hourly paid employees are covered by a plan negotiated through their union. The following specifications, although hypothetical, are very similar to those of a plan which was recently approved by the Internal Revenue Service.

1. *Type of Plan:* The plan will be a fixed-benefit pension plan. (This was chosen over a profit sharing plan since greater credit can be allowed for past service, resulting in larger benefits for the owner-employee.)

2. *Eligibility:* All full-time salaried employees who have completed 3 years of service and are age 30 to 55, inclusive, shall participate. (The waiting period and age requirement will eliminate most short term employees and out of 19 salaried employees, only 11 will be eligible to participate.)<sup>27</sup>

3. *Retirement Date:* (a) Normal retirement shall be at age 65, (b) Early retirement is permitted providing an employee has completed 15 years of service and has reached age 60 and shall be an actuarially reduced amount, (c) Late retirement is permitted with the consent of the Board of Directors.<sup>28</sup>

4. *Retirement Benefit:* Participants who at retirement have 30 or more years of service shall be entitled to a retirement income equal to 15% of the first \$400. of his monthly base salary, plus 40% of his monthly base salary in excess of \$400. Participants with less than 30 years service will receive a proportionately reduced pension. (A higher percentage pension on salary over \$400. is permitted, within certain limits, in order to compensate for the fact that Social Security provides reduced benefits on the salary over \$400.)<sup>29</sup>

<sup>25</sup> U. S. Bureau of Labor Statistics, Dept. of Labor, Bull. No. 1405, Health and Insurance Benefits and Pension Plans for Salaried Employees 10 (1964).

<sup>26</sup> *Ibid.* at 12.

<sup>27</sup> Int. Rev. Code of 1954, § 401 (a) (3) (B).

<sup>28</sup> Treas. Regs. § 1.404 (a)-(3) (b).

<sup>29</sup> A differential of 25 points between the percentage benefit granted on the first \$400. of monthly salary and the percentage benefit granted on the salary over \$400. is permitted under the proposed regulations issued by the Commissioner on July 6, 1968; 26 C.F.R. Part 1 (1968).

5. *Death Benefits*: If a participant dies before retirement, life insurance equal to 100 times his monthly retirement income will be paid to the beneficiary he designates.<sup>30</sup> (Since the insurance will be issued on a group underwriting basis, most, if not all, will be issued without evidence of insurability.) If a participant dies after retirement, his beneficiary will receive the remainder of the unpaid installments to complete 60 months' income, however, in any event the participant will receive an income for as long as he lives. An actuarially equivalent income paid on a joint and survivor or some other basis is also available, as is a lump sum settlement.

6. *Severance Benefit*: Should the employment of a participant be terminated for reasons other than retirement or death, he shall receive a percentage, based upon his years of service, of the cash value of the insurance contract on his life. The terminated participant may continue his insurance coverage personally. (Upon termination a participant forfeits part of his interest in the plan, and this has been found to be a factor reducing employee turnover.)<sup>31</sup>

7. *Funding*: The Plan will be "split-funded"—that is, part of the employer's contribution will be invested in a convertible life insurance contract and part in a Trusteed Fund, which will be invested in stocks, bonds, mortgages, mutual funds, savings accounts, etc. The insurance contract will make all payments in the event of death or termination of employment before retirement, and provide for part of the monthly retirement income. When a participant retires, the insurance contract is converted to an annuity on a guaranteed basis by withdrawing the required amount from the Trusteed Fund. With the consent of the employee, the insurance contract can be converted to variable annuity or a cost of living annuity. (This method of funding permits flexibility both in terms of annual contribution and investment.)

The preceding table shows the benefits and cost of the plan described in the specifications above, as applied to the eleven hypothetical eligible employees. Any amounts payable under Social Security would be in addition to the amounts shown as Monthly Pension. The annual cost has been calculated assuming level funding from date of eligibility to normal retirement date.<sup>32</sup> Other funding methods are available that would produce a smaller normal annual cost plus an accrued (supplemental)

---

<sup>30</sup> Treas. Regs. § 1.401-1 (b) (1) (i).

<sup>31</sup> President's Comm. Report, *supra* note 2, at 27.

<sup>32</sup> The assumptions used were Group annuity 1951 mortality, T-O turnover, and 4 percent interest. The cost would be deductible under Int. Rev. Code § 404 (a) (1) (A) and (B).

## ILLUSTRATION OF BENEFITS AND COSTS

(1) Code	(2) Age & Sex	(3) Total Years Service	(4) Monthly Salary	(5) Monthly Pension	(6) Lump Sum Equivalent of Pension	(7) Death Benefit	(8) Annual Cost
1	54M	30	\$3333.33	\$1233.33	\$189,578.86	\$123,333.00	\$15,913.92
2	48M	27	1266.67	366.00	56,145.50	36,600.00	2,873.35
3	50M	20	1075.00	220.00	33,791.34	22,000.00	2,005.96
4	39M	30	1000.00	300.00	45,927.90	30,000.00	1,378.12
5	42M	28	750.00	186.67	28,603.82	18,667.00	1,010.20
6	35M	30	733.33	193.33	29,598.63	19,333.00	732.93
7	45M	30	716.67	186.67	28,612.96	18,667.00	1,203.83
8	32M	33	683.33	173.33	26,517.41	17,333.00	574.78
9	41M	27	625.00	135.00	20,675.12	13,500.00	693.32
10	49F	20	475.00	60.00	10,461.84	6,000.00	540.52
11	35F	30	400.00	60.00	10,435.44	6,000.00	240.39
							\$27,167.32
Less Federal Income Tax Credit (Est. 48%)							13,040.31
COMPANY FIRST YEAR COST AFTER TAX							\$14,127.01

liability<sup>33</sup> toward which there is a good deal of flexibility regarding the amount of the annual contribution.<sup>34</sup>

As is shown in the table, almost 60% of the corporation's annual contribution goes to fund the benefit of the owner-employee, and more than 80% of the contribution is attributable to the four key employees. Assuming that the corporation is in the 48% tax bracket (ignoring any surcharge) the \$27,167.32 deduction which the corporation will take for its contribution will result in a tax saving of \$13,040.31 leaving an after tax cost of \$14,127.01. In other words, the tax savings alone pays for the benefits of the ten employees other than the owner, in addition to which he has the advantage of a tax sheltered investment and several extremely attractive methods for withdrawing his benefits from the plan, as enumerated above.

### Qualification

The tax advantages contained in the Code have been important, the President's Committee on Private Retirement Plans felt, in two ways. "Federal tax provisions have been both a major influence in shaping the rapid growth of private pension plans and one of the most important forms of public regulation."<sup>35</sup> This regulation is achieved by only grant-

<sup>33</sup> Deductible under Int. Rev. Code § 404 (a) (1) (C).

<sup>34</sup> However, the Accounting Practices Board of the American Institute of Certified Public Accountants has laid down some guidelines for the funding of an accrued liability. See Accounting Principles Board, American Institute of Certified Public Accountants, Inc., Opinion of the Accounting Principles Board, No. 8: Accounting for the Cost of Pension Plans (1966).

<sup>35</sup> President's Comm. Report, *supra* note 2, at 12.

ing the tax advantages to plans that qualify under the criteria of the Code, not only in form, but in substance.<sup>36</sup>

Since the Internal Revenue Service will issue advance determination letters, normally a copy of the plan and any related trust agreement, along with supporting schedules showing the benefits, costs, and other data for the participating employees, and a description of the methods, factors, and assumptions used in estimating the cost of the plan will be submitted to the Service before any irrevocable actions are taken. If it is found that the plan qualifies the District Director will issue a favorable determination letter.<sup>37</sup>

The basic regulations concerning employee coverage are contained in "Requirements for Qualification" [Section 401(a)] which among other things, requires that a plan must meet either a percentage test or a classification test. The percentage test, contained in Section 401(a)(3)(A) permits a plan to qualify if it covers 70% of all employees. (If a plan is contributory, of the 70% of the employees who must be eligible, 80% must choose to participate.) For the purposes of this section however, a person is only counted as an employee if he has: (1) been employed longer than a minimum period prescribed in the plan, but not to exceed five years; (2) worked more than 20 hours in any one week; and (3) worked more than 5 months in any calendar year.<sup>38</sup>

As an alternate to the percentage test an employer can choose to qualify his plan, as are the majority of plans, under the classification test contained in Section 401(a)(3)(B). Under the classification test a plan can be approved which covers a classification of employees as long as its eligibility requirement does not result in discrimination in favor of the "Prohibited group," comprised of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees. However the Code goes on to state that a classification shall not be considered discriminatory merely because it is limited to salaried or clerical employees.<sup>39</sup> In addition, under either the percentage or the classification test a plan may not discriminate in favor of the prohibited group in terms of contributions or benefits.<sup>40</sup>

In the words of Isidore Goodman, Chief of the Pension Trust Branch of the Internal Revenue Service, speaking before the Sixteenth Annual Midyear Conference of Tax Executives, "All that this means is that a classification which is limited to salaried or clerical employees is not for this reason alone considered discriminatory. Conversely such a classifi-

<sup>36</sup> H.S.D. Co. v. Kavanagh, 191 F. 2d 831 (6th Cir. 1951).

<sup>37</sup> See Appendix B.

<sup>38</sup> Int. Rev. Code of 1954, Sec. 401 (a).

<sup>39</sup> *Ibid.* § 401 (a) (5).

<sup>40</sup> *Id.* § 401 (a) (4).



cation is not automatically nondiscriminatory.”<sup>41</sup> Mr. Goodman went on to say that, “A determination whether a classification is not discriminatory is a matter of judgment; it is purely subjective.”<sup>42</sup>

Early in 1966, the Internal Revenue Service, in an effort to clarify this area, issued a series of four Revenue Rulings, each dealing with a specific fact situation concerning a salaried-only classification. In Rev. Rul. 66-12<sup>43</sup> there were 83 hourly employees excluded and 26 salaried participants covered by a pension plan, of whom 11 were either officers, stockholders, supervisors, or highly compensated employees. The Service noted that the compensation of each of the remaining 15 participants was substantially the same as that of the excluded hourly employees, and held that such a classification in this particular situation did not result in covering primarily employees in whose behalf discrimination was prohibited. Further, since the plan was not discriminatory standing by itself, it was immaterial whether the excluded employees were covered under a comparable plan, although in fact they were not.

The second ruling<sup>44</sup> concerned an employer with 20 employees, two of whom were participants in the profit-sharing plan and also officers, supervisors, and compensated at a rate substantially higher than the hourly employees. Since the classification resulted in the covering of two employees, both of whom were members of the prohibited class, it was found to be discriminatory.

The next two rulings involved employers with hourly paid employees who are unionized. In the third situation<sup>45</sup> the employer had 60 employees, 54 of whom were excluded as hourly-paid and in whose behalf the employer did not contribute to any plan. Of the six plan participants, five were officer-stockholders who earned \$26,000. per year (considerably more than the hourly employees earned) and the sixth earned \$6,160. per year. The employer argued that since he had a strict obligation to bargain in good faith with the duly designated representative of the employees, he could not unilaterally include union employees in the plan. The Service responded that this did not alter the fact that the classification resulted in discriminating and therefore the plan would not meet the coverage requirements.

The last Revenue Ruling of the series, 66-15,<sup>46</sup> concerns an employer whose 56 hourly employees were unionized and in whose behalf con-

---

<sup>41</sup> Address by Isidore Goodman, Chief of the Pension Trust Branch of the Internal Revenue Service, Third Session of the Sixteenth Annual Midyear Conference of Tax Executives Institute (March 24, 1966) in P-H Pension and Profit Sharing Serv. ¶ 19,034.2.

<sup>42</sup> *Ibid.* at ¶ 19,034.3.

<sup>43</sup> Rev. Rul. 66-12, 1966-1 Cum. Bull. 626.

<sup>44</sup> Rev. Rul. 66-13, 1966-1 Cum. Bull. 626.

<sup>45</sup> Rev. Rul. 66-14, 1966-1 Cum. Bull. 628.

<sup>46</sup> Rev. Rul. 66-15, 1966-1 Cum. Bull. 629.

tributions approximating 4% of compensation were made to qualified industry-wide retirement plan. The salaried-only profit sharing plan had six participants, three of whom were considered highly compensated. The contributions to the profit sharing plan could be a maximum of 15% of the covered compensation. Here the Service held that taken as a unit the two plans would meet the coverage requirements of the Code, but since the rate of contributions discriminated in favor of the prohibited classes, this approach would not be acceptable; and that since the salaried-only plan by itself resulted in a discriminatory classification, the plan could not be approved.

It is interesting to compare Rev. Rul. 66-12 with 66-15. In the first the salaried-only classification was found to be acceptable even though there was no plan for hourly employees since the salaried plan was not discriminatory standing by itself. In 66-15 the salaried-only plan could not stand by itself, and if the salaried and hourly plan were taken as a unit, the contributions were discriminatory.

There have been frequent attempts to derive some percentage test from the four preceding Revenue Rulings. Commenting on this, Mr. Goodman has repeatedly insisted that no acceptable percentages are to be inferred, and has rather stated that a plan may satisfy the applicable requirements if the salaried employees who are covered "constitute a fair cross section of employees in general."<sup>47</sup> Although there has been no definition of a fair cross section, on March 11, 1968, Mr. Goodman stated that it would include "high paid, low paid, and a fair representation of the employees in between."<sup>48</sup>

Several additional questions are brought to mind. What constitutes highly compensated or supervisory personnel? Are all officers and stockholders members of the prohibited class, or only those officers who are in positions of responsibility and those stockholders who have significant holdings? In his speech on March 24, 1966, Mr. Goodman inferred that a stockholder who owned less than 5% of the outstanding stock of a Company would not be considered a member of the prohibited group.<sup>49</sup>

These questions were touched on at the District Court level and the Tax Court level in what appears to be judicial approval of Rev. Rul. 66-14. In both plans there were hourly paid union members who were excluded from a salaried only plan and not covered under any other plan.

---

<sup>47</sup> Goodman, *supra* note 41, at ¶ 19,034.17; Goodman, 20th Annual Conference of the Council of Profit Sharing Industries (September 29, 1967) in P-H Pension and Profit Sharing Serv. ¶ 19,041.17; Goodman, Association for Advanced Life Underwriting (March 11, 1968) in P-H Pension & Profit Sharing Serv. ¶ 19,043.21.

<sup>48</sup> Goodman, *supra* note 47, at ¶ 19,043.21.

<sup>49</sup> Goodman, *supra* note 41, at ¶ 19,034.4.

The District Court, in, *John DuGuid and Sons, Inc. v. U. S.*<sup>50</sup> found that it would be hard to categorize the three salaried participants as highly paid. However, since the three constituted the Company's two owner-managers and its one supervisor, the Court held that the officer, stockholder, and supervisory quality of their work was evident, and hence found the plan resulted in discrimination in favor of the prohibited group. The Court also approved the use of the fair cross section test as a rule of thumb used on the administrative level to effectuate the statutory purposes.

In, *Ed and Jim Fleitz, Inc., et al.*,<sup>51</sup> the Tax Court held that the prohibited discrimination occurred where three salaried participants constituted the company's three officers, two of whom owned all of the stock, and their annual salaries were approximately twice that of the excluded hourly employees.

Perhaps the most illuminating case is *Commissioner of Internal Revenue v. Pepsi-Cola Niagara Bottling Corp.*<sup>52</sup> where the U. S. Court of Appeals for the Second Circuit reversed a Tax Court finding that a salaried classification did not discriminate. At issue was the term "highly compensated," and the Court held that this was a relative term, comparing the compensation of the participants with the hourly employees who were not eligible to participate. The Court avoided the question of just how much penetration of the covered group by the uncovered group would require the Commissioner to find the plan acceptable.

## Conclusion

The tax advantages the Internal Revenue Code grants to qualified private retirement plans will continue to be a powerful incentive for their adoption. It can be expected that in the future the interest of employers in plans limited to salaried employees will persist. Plans limited to salaried employees hold out a great deal of promise to both the employer and the attorney, however in a field where the administrative agency involved refuses to implement an objective standard but continues to use subjective tests, there is certainly room for caution and expert advice.

---

<sup>50</sup> *John DuGuid and Sons, Inc. v. U. S.*, 278 F. Supp. 101 (N.D. N.Y. 1967).

<sup>51</sup> *Ed and Jim Fleitz, Inc.*, 50 T.C. 384 (1968).

<sup>52</sup> *Commissioner of Internal Revenue v. Pepsi-Cola Niagara Bottling Corp.*, USCA 2d No. 456 (June 20, 1968), rev'g 48 T.C. 75 (1967).

APPENDIX A

**Table 8. Distribution of Private Pension Plans by Industry Group and Type of Worker Covered, Winter 1962-63**  
(Workers in thousands)

Industry	Type of worker covered									
	All plans		Salaried and production		Production only		Salaried only		Earning in excess of a specified amount	
	Number Workers <sup>1</sup>	Plans Workers <sup>1</sup>	Number Workers <sup>1</sup>	Plans Workers <sup>1</sup>	Number Workers <sup>1</sup>	Plans Workers <sup>1</sup>	Number Workers <sup>1</sup>	Plans Workers <sup>1</sup>	Number Workers <sup>1</sup>	Plans Workers <sup>1</sup>
All plans studied	15,818	15,621	6,038	6,263	4,925	7,039	3,995	1,584	860	735
Agriculture, forestry, and fisheries	75	26	66	12	9	13	—	—	—	—
Mining	316	327	55	28	50	257	211	42	—	—
Contract construction	449	1,072	60	23	389	1,049	—	—	—	—
Manufacturing	9,257	9,678	2,392	3,951	3,802	4,147	2,359	1,000	704	581
Transportation	673	1,286	144	192	354	876	133	79	42	140
Communications and public utilities	849	1,270	785	1,182	63	81	1	7	—	—
Wholesale and retail trade	1,627	920	697	368	107	395	715	149	108	7
Wholesale trade	1,147	479	417	63	76	330	554	83	100	4
Retail trade	480	440	280	305	31	66	161	66	8	3
Finance, insurance, and real estate	1,853	733	1,478	429	13	15	356	282	6	8
Services	719	308	361	77	138	206	220	25	—	—

<sup>1</sup> Active workers in 1961.

NOTE: Because of rounding, sums of individual items may not equal totals.

(Copied from U. S. Bureau of Labor Statistics, Dept. of Labor, Bull. No. 1407, Labor Mobility and Private Pension Plans 55 (1964))

APPENDIX B

U. S. TREASURY DEPARTMENT  
INTERNAL REVENUE SERVICE

District Director  
P. O. Box 6901  
Cleveland, Ohio 44101  
Nov. 9, 1967

In Reply Refer to

-----Company  
-----Street  
Cleveland, Ohio

----- Company  
Re: Salaried Employees  
Retirement Income Plan

Gentlemen:

You desire a determination as to whether the trust established under a trust indenture executed by you on July 26, 1967 and which forms a part of your employees' pension plan is a qualified trust under Section 401(a) and exempt from income tax under the provisions of Section 501(a) of the Internal Revenue Code.

The plan, as evidenced by the trust indenture and other relevant information submitted with the request for a determination, has been considered and this office is of the opinion that the plan meets the requirements of Section 401(a) of the Internal Revenue Code, and that the trust established thereunder is entitled to exemption under the provisions of Section 501(a). Attention, however, is invited to Section 1.401-1(b) (3) of the Income Tax Regulations under the 1954 Code which states in part: "The law is concerned not only with the form of a plan but also with its effects in operation."

The trust, being exempt under Section 501(a) of the Code, is subject to the provisions of Section 502 (*relating to feeder organizations*), Section 503 (*relating to prohibited transactions*), and Section 511 to 515, inclusive, (*relating to tax on unrelated business income*). It is also required to file an annual return (*Form 990-P*) as prescribed by Section 6033 of the code. This office should be notified in writing in the event of amendment or termination of the plan or trust.

Subject to the conditions and limitations of Section 404 of the Internal Revenue Code and to verification upon examination of your return, deductions from gross income will be allowed an account of contributions made under the plan to the trust.

Under the provisions of Section 1.402(a)-1(a) (3) of the Income Tax Regulations under the 1954 Code, the portion of the premiums paid for

life insurance protection provided under contracts will constitute income to the employee for the year in which contributions are applied toward the purchase of such life insurance.

This determination is in accordance with the pertinent provisions of the Internal Revenue Code and is not a determination regarding the applicability of other Federal statutes.

*[Illustrative Internal Revenue Service  
Determination Letter]*

Very truly yours,

F. S. Turbett, Jr.,  
District Director

cc-Central National Bank

RL 4-49 (10/58)