APPENDIXES

APPENDIX A

THE ORIGIN AND EVOLUTION OF TAX ADVANTAGES FOR RETIREMENT SAVING

Tax advantages for retirement saving were first granted to employer pensions in the 1920s. The advantages were not extended to personal retirement saving until 1962, and even then did not become widely available until 1982.

EARLY TRENDS IN PENSION COVERAGE

Formal pension plans in the United States began in the nineteenth century. The American Express Company started the first employer plan in 1875, followed by the Baltimore and Ohio Railroad in 1880. By 1900 a few banks and public utilities had plans. Employer plans burgeoned in the first two decades of the 20th century among railroads, public utilities, and large manufacturing firms, particularly in the oil and steel industries. Several unions, especially in the railroad and construction industries, started formal plans before 1920. During the 1920s, the growth of employer plans slowed and shifted to smaller firms. Union plans, however, continued to expand. 1/

Private pensions emerged during this period as a response to changing family ties and business structures. Urbanization was weakening the extended family that had formerly supported those too old to work. Also, the number of elderly persons was growing rapidly as earlier immigrants aged and life spans increased.

Large corporations needed systematic and publicly acceptable ways of removing elderly workers. Pensions offered a solution to this problem and at the same time provided an incentive for younger employees to work

1. The source for much of this section is Murray W. Latimer, *Industrial Pension Systems* (New York: Industrial Relations Counselors, Inc., 1932), pp. 17-61; and Latimer, *Trade Union Pension Systems* (New York: Industrial Relations Counselors, Inc., 1932), pp. 1-36.

steadily and compliantly. Public acceptability was probably another motivation, because pensions were most common where government oversight was strongest--in railroads, public utilities, and the largest industrial combines. Also, since these firms were more financially secure than smaller firms in more competitive industries (at least until the Depression), these companies could better afford to offer pensions.

By 1929, employer plans covered up to 15 percent of private employees. Coverage was concentrated in railroads (80 percent), public utilities (50 percent), the cable, telephone, and telegraph industry (90 percent), and to a lesser extent in manufacturing (less than 12 percent). Employer plans in construction, mining, sales, and most services were essentially nonexistent. 2/ By 1930, union pensions had spread to over a dozen national unions, primarily in construction, railroads, and printing, and covered one-fifth of all unionized workers. 3/

The income tax enacted in 1913 made no special provision for employer or individual retirement funding. In the first year of operation, though, the Internal Revenue Service ruled that pensions paid to retired employees were deductible, like wages, as an ordinary and necessary business expense. 4/ Rulings in 1918 and later also allowed employers to deduct contributions to pension trust funds. These contributions had to be declared as taxable income by someone in the year contributed, however; they were assigned to employees, the trust, or to employers, depending on who had control over the funds and on the certainty of obtaining benefits. 5/ Trust earnings were similarly taxable in the year earned. In cases where trust contributions and earnings were taxable to employees, beneficiaries would not be taxed on withdrawals from a fund during retirement, just as if the trust had been personal saving. Employee contributions to retirement trusts, even if required by the employer, were not deductible.

2. Latimer, *Industrial Pension Systems*, p. 55.

3. Latimer, *Trade Union Pension Systems*, pp. 27-32.

4. Treasury Decision 2090, issued December 14, 1914.

5. Jacob Mertens, Jr., *The Law of Federal Income Taxation*, vol. 4A, 1979 rev. (Wilmette, Illinois: Callaghan, 1979), Sec. 25 B.02, p.5.

The 1920s

The Revenue Act of 1921 included the first provision exempting employer-funded trusts from tax, but it applied only to stock-bonus or profit-sharing plans. 6/ Pension trusts were not included in the exemption until the Revenue Act of 1926. After the 1926 act, employers could fund in tax-free trusts their currently accruing pension liabilities, but contributions to cover past service accruals were not allowed. Since many plans were new and most had never been fully funded, firms had large liabilities from past years' accruals. Some began accumulating taxable reserves for these obligations on their corporate balance sheets. By 1928, at least 20 percent of the non-railroad plans were supported by such reserves. 7/ In response to these accumulations, the Revenue Act of 1928 permitted "reasonable" contributions to pension trusts beyond the amounts needed for currently accruing liabilities. 8/ Passage of the 1928 Revenue Act completed important pension legislation for a decade.

The Revenue Acts of 1921 and 1926 were major, controversial tax bills, but the Congress paid scant attention to the sections granting tax exemptions to employer benefit trusts. The 1921 provision was inserted by

6. Revenue Act of 1921, ch. 136, sec. 219(f). Stock-bonus and profit-sharing plans were seen at the time primarily as a means to motivate job performance. Promoting all-purpose saving was seen as a secondary goal. Employers typically would set up trusts that held company stock for the employees. Employees would earn title to the shares by a combination of their own contributions, collection of dividends by the trust, and employer contributions. The dividends and frequently the employer's contribution depended on the profitability of the firm. Employees quitting before paying in full usually forfeited ownership of the stock and a portion of the dividends and employer contributions. Participation could also be revoked for striking or other behavior disapproved of by the employer. Employee stock ownership, and this installment purchase system, were thought to encourage conscientious work, stability of employment, and a cooperative attitude. Plans with some form of trust existed in the 1880s and became more popular after 1900. During passage of the trust tax exemption, employee enrollment in stock-bonus plans was low but rapidly growing: 338,888 employees subscribed to stock purchases between 1918 and 1925. See Boris Emmet, *Profit Sharing in the United States*, Bulletin 208 of the U.S. Bureau of Labor Statistics (1917), pp. 85-157; Nicholas Paine Gilman, *Profit Sharing Between Employer and Employee*(Freeport, N.Y.: Books for Libraries Press, 1889, reprinted 1971), pp. 296-360; and Gorton James and others, *Profit Sharing and Stock Ownership for Employees* (New York: Harper and Bros., 1926), p. 24.

7. Latimer, *Industrial Pension Systems*, p. 582.

8. Latimer, *Industrial Pension Systems*, pp. 661-662. See also Revenue Act of 1928, ch. 852, sec. 23(g).

the Senate Finance Committee and accepted as uncontroversial on the floor. The 1926 extension to pensions was offered as a floor amendment in the Senate only hours before passage and was also accepted without debate. Clearly, the Congress did not foresee how costly and influential the exemption would later become. In fact, the absence of floor debate or discussion in committee reports makes it unclear whether the exemption was intended as assistance to employers' nascent benefit plans or purely as a technical resolution of the difficult problem of assigning trust income to a taxable entity. The absence of restrictions on the use of the exemption is striking by today's standards. No minimum funding requirement or any maximum benefit limit was imposed. 9/ Further, the employer could take back funds as it felt necessary, limit eligibility in any way desired, and alter or terminate the plan at any time.

As broad as the tax exemption became in the 1920s, it had little influence on the development of employer pensions before World War II. In the 1920s, only 1 percent of the population paid any income tax, and rates were 8 percent or less for many of those who paid. Corporate rates were only 12 percent to 13 percent. As late as 1939, just 5 percent of the population paid income tax and those with moderate incomes still paid only 8 percent. In 1939, the maximum corporate tax rate was only 18 percent. 10/ With rates so low, employees gained little, as compared with private saving, from employer contributions to trusts. Moreover, employers saved little on their contributions as compared with the taxes due on higher profits.

The 1930s

During the Depression, corporate incomes plunged and bankruptcies were common. Firms responded by cutting their pension contributions. Because

9. Employer contributions were deductible as ordinary and necessary expenses under Section 23, as referenced in footnote 4. Section 23 (a) contains the phrase, "including a reasonable allowance for salaries or other compensation for personal service actually rendered, . . ." This phrase was not intended as a maximum on contributions when legislated in 1919, but by the 1940s was ruled to imply a maximum. See Rainard B. Robbins, *The Impact of Taxes on Industrial Pensions* (New York: Industrial Relations Counselors, 1949), pp. 16-19.

10. Percentages paying the tax are from Richard Goode, *The Individual Income Tax* (Washington, D.C.: Brookings, 1976), p. 4. Tax rates are from *Annual Tax Rates, 1913 to 1940*, "Extract from the Annual Report of the Treasury on the State of Finances for the Fiscal Year 1940" (Government Printing Office, 1941), pp. 466-473.

of the extensive use of current funding, this cutback necessitated sharp reductions in benefits even for those already retired. Many firms terminated their plans. Union membership also declined dramatically, thereby reducing the contributions available to pay union pensions; in the course of a few years, almost all union plans had collapsed. 11/

The Depression's economic damage to aging workers and the retired went beyond the loss of employer pensions. Personal savings were wiped out by the collapse of financial markets, the plunge in home and farm prices, and extended unemployment. Struggling families were hard pressed to support already retired family members.

To fill the breach caused by the collapse of existing old age supports, the federal government established Social Security and the Railroad Retirement System in 1935. The railroad pensions were singled out for rescue because their pension obligations were so large relative to the railroads' ability to pay and because so many people were involved. One-quarter of the railroads' work force, or 250,000 people, were near retirement. The Railroad Retirement System made good on the companies' pension promises with federal funds, and set up a continuing pension system intended to be funded by employers and employees.

The Social Security System extended retirement support far beyond those previously covered by private pensions, using an employer-employee funding mechanism like that of the Railroad Retirement System. Both systems, of course, had to start with current funding, but they were to accumulate trust funds. Since the Depression, the federal government has thus provided a minimum level of retirement income for most elderly Americans.

Some employer pension plans survived the Depression. As the economy slowly revived in the latter half of the 1930s, new pension plans were started. At the end of 1938, about 500 plans were active, up from about 400 in 1929. In spite of the rise in the number of plans, only about half as many workers were covered in 1938 as had been in 1929 before the collapse. 12/

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11. William C. Greenough and Francis P. King, *Pension Plans and Public Policy* (New York: Columbia University Press, 1956), p. 41.

12. Robbins, *Impact of Taxes on Employer Pension Plans*, pp. 27-28; and Latimer, *Industrial Pension Systems*, p. 55.

The revival of employer plans in the late 1930s brought the first suggestions for controlling use of the tax exemption. In 1937, the Joint Committee on Tax Evasion and Avoidance noted the possibility of using pension trusts to avoid taxes. 13/ The committee included in its hearing a statement from the Internal Revenue Service recommending that firms using the trust exemption (1) be restricted from recapturing earlier contributions to pension trusts, (2) be required to include a reasonable number of employees in the plans, and (3) be limited in the size of pension that could be funded. Response to the first suggestion came in the Revenue Act of 1938. It required that employer contributions to an exempt trust could not be revoked until all liabilities of the plan had been paid. Until 1938, firms could shelter profits from taxation by contributing to pension trusts when profits were positive and withdrawing those funds when profits were negative. Action on the second suggestion came in 1942, but the third had to wait until 1974.

POSTWAR LEGISLATIVE HISTORY

The war effort created strong incentives for the expansion of employer pensions. To finance the war, income taxes were sharply increased and an excess profits tax was added. Only 5 percent of the population had paid income taxes in 1939; by 1946, 75 percent paid them. Corporations were paying up to 80 percent of their profits in tax. As a result, the pension trust tax exemption became much more valuable to a broad cross-section of the population. Further, wage controls limited pay increases but not pension benefits. Thus, during World War II businesses were able to use pensions as a major incentive to attract workers, and pensions grew rapidly. While only 515 plans existed in 1938, by 1946 there were about 7,000 of them covering about 3.3 million employees.

The 1940s

The Congress recognized that high wartime taxes greatly increased the value of the pension trust tax exemption. Because of the need for revenue to pay for the war, it could well have eliminated the exemption. Instead, in the Revenue Act of 1942, it chose to keep the incentive for pensions, but to impose conditions designed to insure that pension benefits were extended to rank-and-file workers. Section 165 of the code was amended so that to qualify for the tax exemption a pension plan could not discriminate in favor

13. Robbins, *Impact of Taxes on Employer Pension Plans*, pp. 27-28.

of officers, shareholders, supervisors, or highly paid employees in terms of coverage, contributions, or benefits. Generally, plans had to cover at least 70 percent or a "fair cross section" of employees, and could not provide proportionately greater benefits for higher-income employees. An important exception was that plans could integrate with Social Security, meaning that the ratio of benefits to earnings paid for earnings above the Social Security earnings base could be somewhat larger than the ratio for earnings below the wage base. The act also amended Section 23(p) to restrict tax avoidance through overfunding of plan liabilities. The concepts and basic conditions set forth in the 1942 act still apply today.

After the war, pension growth temporarily slowed, but the continued high tax rates and strong interest in pensions by employees, especially by organized labor, spurred rapid pension growth in the late 1940s and through the 1950s. In 1946, the United Mine Workers of America won an employer-funded pension that was jointly administered by the union and the mine owners. This set a modern precedent that was followed by other multi-employer plans in the building trades, trucking, and elsewhere. Section 302 of the Taft-Hartley Act, in response to the mining industry plan, established guidelines for collectively-bargained multiemployer plans. 14/ Then, in 1948, the United Steel Workers succeeded in forcing Inland Steel to include pensions in contract bargaining. Single-employer plans were later expanded or added in the steel and auto industries, setting a precedent for single-employer plans in related industries.

The 1950s and 1960s

Private pension plans covered 9.8 million workers in 1950, or 22.5 percent of the private work force. The rate of coverage grew rapidly during the 1950s, increasing to 37.2 percent in 1960. Coverage grew more slowly during the 1960s, increasing to 42.1 percent in 1970, but pension plan assets continued to grow rapidly. By 1970 pension assets totaled $137 billion, compared with only $12 billion in 1950. Legislative concern during this period centered mainly on curbing abuses in the management of plan assets and expanding pension coverage to the self-employed.

The explosive growth of plan assets was accompanied by enough cases of fund mismanagement and abuse to bring federal intervention. The Welfare and Pension Plans Disclosure Act of 1958 provided for registration, reporting, and disclosure of the financial operations of welfare and pension

14. The Labor Management Relations Act of 1947, 61 Stat. 136, Public Law 80-101.

plans, in the hope that if the law forced more complete disclosure, beneficiaries would act to curb abuses. Experience with the 1958 act appeared unsatisfactory, and in 1962 amendments were added granting the Secretary of Labor enforcement powers. Kickbacks, embezzlement, and false statements on required documents were declared felonies.

The Self-Employed Individuals Tax Retirement Act of 1962 first allowed self-employed persons to establish and maintain pension plans. Previously, participation in tax-qualified plans had been limited to employees. The act laid down rules for qualified pension plans for self-employed persons, unincorporated small businesses, farmers, professional people, and their employees. These plans became known as Keogh plans, after their House sponsor. The act amended prior law on plan enrollment, distributions, and management to allow for the special case of self-employed individuals. Safeguards against discrimination were also included.

ERISA

In the 1960s, public concern mounted that workers could not count on pension benefits even after many years of service. The concern led the Congress and the Executive Branch to consider comprehensive federal standards for employer pensions. Twelve years of effort culminated in the passage of the Employee Retirement Income Security Act of 1974. ERISA greatly expanded protections for participants in employer plans and created individual retirement accounts (IRAs) for those whose employers offered no plan.

Provisions for employer plans included minimum standards for participation, vesting, and funding. Also, responsibilities for the handling of plan assets were detailed, and the Pension Benefit Guaranty Corporation (PBGC) was created to insure the benefits of employees in defined benefit plans against plan termination.

Under the act, plans could not set a minimum age for participation of over 25 years of age nor a minimum service requirement of more than one year. One of three minimum vesting standards had to be met, the most commonly chosen of these being full vesting at 10 years of service. Employers were also required to fund their plans' supplemental liabilities over specified times. Previously, only the interest on these liabilities had to be funded.

ERISA set a limit for the first time on the annual benefit for which any individual may be funded. Under a defined benefit plan, the maximum allowed was the lesser of $75,000 (subject to cost-of-living adjustments) or 100 percent of the employee's highest three-year average pay. Under a defined contribution plan, the maximum allowed was the lesser of $25,000 (cost-of-living-adjusted) or 25 percent of compensation.

ERISA also broadened the use of and raised the funding limits for individual retirement vehicles. Self-employed individuals with Keogh plans were now allowed to deduct the lesser of 15 percent of their earned income or $7,500 per year. In addition, employees not covered by a qualified or governmental plan or a tax-deferred annuity were permitted to establish individual retirement saving plans with the same deferral of tax on their contributions and investment earnings as Keogh plans. A maximum limit was set on contributions at 15 percent of annual compensation, but no greater than $1,500.

Legislation Since ERISA

Since ERISA, legislation has tried to limit new excesses in use of the trust tax exemption and at the same time support the evolution of many alternatives to the basic pension. These alternatives include expanded IRAs, special tax incentives for Employee Stock Ownership Plans (ESOPs), salary reduction plans, and so-called cafeteria plans.

All major tax legislation since ERISA has contained some provisions affecting tax-favored asset accumulation. The Tax Reduction Act of 1975 instituted a tax credit for Employee Stock Ownership Plans (ESOPs). 15/ The credit was an add-on to the investment tax credit enacted at that time. Firms taking the investment credit could claim an additional 1 percent

15. ESOPs are trusts set up by the employer to hold stock of the firm for employees. Stock-bonus plans, along with profit-sharing plans, have existed since the late 1800s and were the beneficiaries of the original employer trust exemption in 1921. Pensions were not included under this exemption until 1926. Stock-ownership and profit-sharing plans were originally thought of as work incentives. Employees with an ownership stake in the firm might be motivated to assist the general well-being of the firm rather than focusing more narrowly on their own job security and pay. However, profit-sharing and stock-bonus plans have provided for asset accumulation that can be used for retirement, and some firms have relied exclusively on such plans for retirement.

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credit for the value of company stock contributed to an ESOP. By setting the credit equal to the value of the stock donated, the government essentially bought the stock and gave it to the plans. The ESOP credit was scheduled to expire in two years but was extended and modified several times. The credit was repealed as of the end of 1986, although some other special incentives for ESOPs were added in 1984 and 1986.

The Tax Reform Act of 1976 extended ESOPs and continued the liberalization of individual retirement arrangements begun in 1962 and 1974. The 1976 act first authorized an IRA for nonworking spouses. The annual dollar contribution limit was $250 in excess of the individual account limit of $1,500. In no case could the total contribution exceed 15 percent of compensation.

The Revenue Act of 1978 boosted three innovative benefit plans. Under Section 401(k), the act allowed an employee to defer portions of his or her regular salary in tax-deferred accounts. These accounts were like IRAs in that the individual could elect amounts to place in the plans (up to plan limits), and avoid all taxes until funds were withdrawn. The funds generally could be held until retirement, though they could be borrowed against or withdrawn in certain circumstances. Nondiscrimination rules were included to prevent the tax deferral from benefiting only the highly compensated employees.

Employers had long offered savings plans to employees, and many of these had matching employer contributions. Employers with tax-qualified plans could deduct their matching contributions, but the employee contributions were taxable. Many of these plans are switching to Section 401(k) plans to avoid tax on the employee contribution, and other employers without thrift plans are starting 401(k) plans because of the more attractive tax treatment.

A second innovative vehicle boosted by the 1978 act was the "cafeteria" or flexible benefit plan. Cafeteria plans allowed employees to select their own mix of fringe benefits including medical plans, life insurance, and many others, but among the retirement savings vehicles only 401(k) plans are included. Cafeteria plans are also spreading rapidly and can affect tax-deferred retirement saving by increasing the availability and use of 401(k) plans.

The Revenue Act of 1978 also created the Simplified Employee Pension (SEP). Following ERISA, many small employers without their own pension plans had started contributing directly to employee IRAs. The act formalized this mechanism as a SEP and raised the maximum SEP contribution to $7,000 from the $1,500 IRA limit. SEPs cannot discriminate in favor of highly compensated employees, and SEP accounts are fully vested. SEPs have not spread as rapidly as 401(k) and cafeteria plans. These latter plans largely substitute for other plans already offered by employers, whereas SEPs are more likely to be started by employers without other employee retirement plans.

Legislation in 1980 attempted to repair flaws in ERISA's termination insurance for multiemployer plans. The ERISA provisions threatened the continuation of multiemployer plans and could have left the Pension Benefit Guaranty Corporation with extensive underfunded liabilities. The Multiemployer Pension Plan Amendments Act of 1980 attempted to preserve the plans and place the insurance on a sound basis.

The Economic Recovery Tax Act of 1981 (ERTA) contained the largest tax cuts in the nation's history. It also extended IRAs to all workers (under the age of 70½) and increased the annual deduction limit for IRA contributions to $2,000 per employee (plus $250 for a spouse without earnings). In addition, employees making voluntary contributions to qualified plans, tax-sheltered annuity programs, or government plans were allowed deductions for their contributions, but such deductions must be included within the IRA limit.

As a result of the changes in ERTA, use of IRAs ballooned. In 1976, just after ERISA first permitted IRAs, 1.8 million people contributed to IRAs. IRAs then grew slowly until enactment of ERTA, reaching 3.4 million in 1981. After the ERTA changes went into effect, the number of tax returns claiming IRA deductions jumped to 12.1 million in 1982 and 13.7 million in 1983.

ERTA also raised the deduction limit for employer contributions to defined contribution H.R. 10 plans (Keogh plans), defined contribution plans maintained by subchapter S corporations (partnerships), and SEPs to $15,000. The 15 percent compensation limit was not changed.

In the face of large deficits, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) offset some of the tax reductions of ERTA. Instead of general rate increases, TEFRA focused on many small adjustment and compliance changes. For pensions, several perceived excesses of the pension tax deferral were curtailed. The maximum funding and contribution ceilings were reduced, new "top-heavy" restrictions were imposed, and several other plan options were limited. On the other hand, the distinctions between plans for the self-employed and other plans were abolished, thus liberalizing the rules for these Keogh plans.

ERISA had established the first dollar funding limit for a defined benefit plan at a $75,000 pension in 1974, and the first contribution limit for a defined contribution plan at $25,000. Both limits were indexed and by 1982 had risen to $136,425 and $45,475 respectively. TEFRA reduced these to $90,000 and $30,000, and froze further indexing until 1986. The limits were extended to SEPs, which doubled their past limits. Thus, between 1974 and 1982, the Congress had reduced real dollar funding limits on employer pensions at the same time it was expanding alternative retirement arrangements and raising their contribution ceilings.

Chief among the other pension restrictions imposed by TEFRA were the rules for so-called top-heavy plans. Plans that provided more than 60 percent of their benefits to key employees were termed top-heavy. To qualify for the tax exemption, these plans had to (1) limit the amount of a participant's compensation that may be taken into account, (2) provide greater portability of benefits for non-key participants by requiring more rapid vesting, (3) provide minimum nonintegrated contributions or benefits for non-key employee participants, and (4) reduce the aggregate limit on contributions and benefits for certain key employees.

The Social Security Amendments Act of 1983 declared that amounts deferred in 401(k) and other salary reduction plans would be considered compensation for payroll tax purposes.

The Tax Reform Act of 1984 was another attempt to reduce the large federal deficit through minor adjustments. For pensions and individual saving plans the result was to draw the Congress deeper into their operational detail without raising significant revenues. The freeze initiated in TEFRA on indexing the maximum funding and contribution limits was extended from 1986 to 1988. Changes were made in the timing of distributions from plans, in top-heavy plans, SEPs, 401(k) plans, cafeteria plans, and ESOPs.

The Retirement Equity Act of 1984 was primarily intended to protect pension-plan coverage of women, both as spouses and employees. Under this act, for spouses, qualified plans must give married employees joint and survivor annuities that can only be waived (in favor of an individual annuity or a lump sum) by a statement of the spouse signed in front of a plan representative. Further, a preretirement survivor annuity must be provided to the spouse of any vested employee if the employee dies before retirement. To protect employees who interrupt work careers for child raising, the latest age of participation, set in ERISA at 25 years, was lowered to 21, and allowable breaks in service were liberalized. Several other specific changes were made such as raising the benefit accruals that can be cashed out, and permitting plans to pay benefits pursuant to a qualified domestic relations order.

The Tax Reform Act of 1986 has made numerous changes in the tax treatment of qualified plans. In a reversal of a decade-long trend, the act curtails use of retirement vehicles allowing individual choice in all defined contribution plans. However, the trend since World War II of requiring broader employee participation and benefit accrual was continued.

Individual choice in tax-advantaged retirement saving was curtailed primarily by phasing out the deduction for IRA contributions among higher-paid employees covered by an employer pension. The $7,000 limit on 401(k) and other salary reduction contributions also limits individual contributions for some higher-paid employees. The act curtails contributions to all defined contribution plans relative to defined benefit plans by leaving the maximum defined contribution frozen until it falls from one-third to one-fourth of the maximum defined benefit (which will be indexed starting in 1988).

The act continued the postwar trend to broaden benefits within employer plans by extending participation, vesting, and integration requirements. The tests for broadness of coverage among employees were made more stringent. Maximum vesting was shortened--e.g., from 10-year to 5-year cliff vesting. The extent to which Social Security benefits can offset employer pension benefits has been reduced as well.

The Tax Reform Act of 1986 also limits further the use of tax-advantaged saving to retirement. Stricter rules apply to withdrawals, and the 10 percent tax on premature withdrawals from IRAs is extended to preretirement withdrawals from other plans. The act and its effects are discussed further in Chapter V of the main text and Appendix B.

POSTWAR PENSION GROWTH

In 1950, private pension plans paid out about $370 million in benefits to about 450,000 beneficiaries. Benefit payments have about doubled every five years through 1980, bringing the figure to $35.2 billion in 1980 (see Table 29). The rate of increase in the number of beneficiaries slowed over

TABLE 29. GROWTH OF PRIVATE PENSION PLANS, 1950-1980

	1950	1955	1960	1965	1970	1975	1980
Number of Plans	12,330	29,938	63,698	115,122	230,262	445,413	627,518
Number of Workers Covered (In millions) a/	9.8	14.2	18.7	21.8	26.1	30.3	35.8
Percent of Work Force Covered b/	22.5	29.6	37.2	39.5	42.1	46.2	47.2
Total Contributions (In billions of dollars)	**2.08**	**3.84**	**5.49**	**8.36**	**14.00**	**29.85**	**68.97**
Employer Contributions	1.75	3.28	4.71	7.37	12.59	27.56	64.84
Employee Contributions	0.33	0.56	0.78	0.99	1.42	2.29	4.13
Contributions to Retirement Plans as a Percentage of Total Wages and Salaries in Private Industry c/	1.67	2.19	2.46	2.86	3.25	4.73	6.68
Number of Beneficiaries (In millions)	0.45	0.98	1.78	2.75	4.75	7.05	9.10
Benefit Payments (In billions of dollars) a/	0.37	0.85	1.72	3.52	7.36	14.81	35.18
Total Plan Assets (In billions of dollars)	**12.1**	**27.5**	**52.0**	**86.5**	**137.1**	**293.5**	**612.3**

SOURCES: Martha Remy Yohalem, "Employee-Benefit Plans; 1975" in *Social Security Bulletin*, November 1977, pp. 19-28; Table 1 in background material attached to memorandum from Don Thibeau, Executive Director of the National Pension Forum, Department of Labor, to the National Pension Forum of the ERISA Advisory Council, June 14, 1984; Alicia Munnell, *The Economics of Private Pensions* (Washington, D.C.: The Brookings Institution, 1982), Table 2.1, p. 11; and EBRI tabulations based on IRS Letters of Determination data.

(Continued)

a. Estimated by the Social Security Administration primarily from data compiled by the American Council of Life Insurance, *Pension Facts 1976*, and the Securities and Exchange Commission, *1975 Survey of Private Pension Funds*. Data adjusted for duplication resulting from participation in more than one plan and the vesting of benefits, using benchmark data from a special household survey of employed workers conducted in conjunction with the April 1972 *Current Population Survey*. Includes pay as-you-go and deferred profit-sharing plans, plans of nonprofit organizations, union pension plans, and railroad plans supplementing the federal railroad retirement program. Excludes pension plans for federal, state, and local employees, tax-sheltered annuity plans, and plans for the self-employed.

b. Coverage of private employees in relation to average number of wage and salary employees in private industry (65.6 million in 1975) from Table 6.7 in Department of Commerce, *Survey of Current Business*, July 1976 and July 1983, and Table 6.7 in Department of Commerce, *National Income and Product Accounts of the United States, 1929-1974* (1977).

c. Amounts for private employees in relation to wages and salaries in private industry ($1,082.3 billion in 1980) from Table 6.6, *Survey of Current Business*, July 1976 and July 1983, and from Table 6.6 in *National Income and Product Accounts of the United States, 1929-1974* (1977).

the period, indicating that average payments per beneficiary were increasing, especially during the late 1970s after the passage of ERISA. ERISA clarified previous guidelines defining service and age requirements that largely determine the minimum rate of coverage. Workers and plan managers (including trade unions) since ERISA have focused more on expanding the benefits available to each enrolled worker than on increasing the percentage of workers enrolled.

Plan assets (or reserves) grew quickly in the 1950s (in nominal terms), more slowly in the early 1960s, and more quickly again in the 1970s. Total assets of private pension plans were about $12 billion in 1950 and about $612 billion in 1980.

Employer contributions to pension plans have risen faster than dollar wages. As a result, contributions have risen from under 2 percent of wages in 1950 to over 6 percent in 1980. Were employer contributions and trust fund investment earnings taxable to the employees when earned, as are wages, federal income taxes on those amounts would have been about $50 billion in 1986.

CONCLUSION

The Congress enacted the tax advantages for employer pensions with little debate in the 1920s. Since then, it has consistently chosen to shore up employer plans when problems arose. This has drawn the Congress further and further into the detailed regulation of employer plans. From 1962 to 1981, the Congress also expanded the range of vehicles for tax-advantaged retirement saving, particularly through individual saving. Clearly, the Congress and the public have felt that employer plans provided an important source of retirement income that merited support. At the same time, they have imposed many conditions on the operation of these plans and have supplemented them through individual saving.