"NINETY-FIVE PERCENT OF [THEM] WILL NOT BE MISSED"†: RECOVERING THE TAX SHELTER LIMITATION ASPECT OF ERISA

Peter J. Wiedenbeck[*]

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INTRODUCTION

ERISA, the Employee Retirement Income Security Act of 1974,[1] is justly hailed as a paramount achievement in labor and social welfare legislation. Congress announced the central goal to protect "the interests of participants in private pension plans and their beneficiaries by improving the equitable character and the soundness of such plans" by imposing vesting, minimum funding, and termination insurance requirements.[2] The statute was, "at its core, a 'reasonable expectations' bill. It gave an ordinary employee the assured right to receive what a reasonable person in his boots would have expected in the circumstances. Primarily, it was a consumer protection bill."[3]

† Remarks of Daniel I. Halperin, *in* Panel Discussion, *Setting the Stage: History Before the Ninety-Third Congress*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 265, 273 (2014); *see infra* text accompanying note 9.

* Peter J. Wiedenbeck is the Joseph H. Zumbalen Professor of the Law of Property, Washington University in St. Louis. The author wishes to thank Norman Stein and James Wooten for organizing the *Drexel Law Review* Symposium, *ERISA at 40: What Were They Thinking?*, held on October 25, 2013.

1. Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in 29 U.S.C. §§ 1001–1461 and in scattered sections of 26 U.S.C.).

2. ERISA § 2(c), 29 U.S.C. § 1001(c) (2012).

3. Frank Cummings, *ERISA: The Reasonable Expectations Bill*, 65 TAX NOTES 880, 881 (1994). As Mr. Cummings observed in the Symposium, "Look, this is a bill that didn't have the sup-

ERISA only incidentally addressed private pension plan coverage: "That wasn't [its] focus. [Its] focus was saying, 'You can promise whatever you want, but if you promise it, you [have] got to deliver it.'"[4] ERISA's four principal policies—promoting informed financial decision making; preventing mismanagement and abuse of benefit programs; protecting the reliance interests of plan participants and beneficiaries; and preserving substantial employer autonomy with respect to plan sponsorship and design—are directed to eliminating misunderstandings and injustices in the operation of a voluntary system of employer-provided pension and welfare benefits.[5]

The worker-protective elements of ERISA tend to get all the glory, but we should not lose sight of Congress's finding that employee benefit plans "substantially affect the revenues of the United States because they are afforded preferential Federal tax treatment . . . ."[6] That finding supported ERISA's coordinate declaration of policy: "to protect . . . the Federal taxing power . . . ."[7] "The tax-subsidized but largely unregulated regime that preceded ERISA frequently frustrated workers' expectations, if not their legal rights."[8] Simultaneously, it facilitated widespread tax abuse. Professor Halperin described the universe of qualified pension, profit-sharing, and stock bonus plans as it existed prior to ERISA's enactment:

> "My clients [small companies] were doing this for tax shelters. . . . [W]hen people said ERISA is going to cause plans to terminate, I said if they cause the plans to terminate, 95% of the plans I drafted will not be missed at all because there was no retirement security for anybody in those plans. They were not worried about minimum funding, they were worried about maximum funding. The plan sponsor[s] wanted to put in as much as they possibly could."[9]

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port of anybody but the people." Remarks of Frank Cummings, *in* Panel Discussion, *Setting the Stage: History Before the Ninety-Third Congress*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 265, 285 (2014).

4. Remarks of Daniel I. Halperin, *in* Panel Discussion, *Some New Ideas and Some New Bottles: Tax and Minimum Standards in ERISA*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 385, 399–400 (2014).

5. PETER J. WIEDENBECK, ERISA: PRINCIPLES OF EMPLOYEE BENEFIT LAW 14–19 (2010) [hereinafter ERISA PRINCIPLES].

6. ERISA § 2(a), 29 U.S.C. § 1001(a) (2012).

7. ERISA § 2(c), 29 U.S.C. § 1001(c) (2012).

8. ERISA PRINCIPLES, *supra* note 5, at 14.

9. Remarks of Daniel I. Halperin, *in* Panel Discussion, *Setting the Stage: History Before the Ninety-Third Congress*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 265, 273; *see also infra* text accompanying note 70.

Reducing wasted revenue by focusing preferential tax treatment on plans providing retirement savings to a broad cross-section of the workforce—not just to the business owners—is the often-overlooked dual objective of ERISA. It deserves to be more widely appreciated, and celebrated.

This Reflection seeks to recover the tax shelter limitation aspect of ERISA. Part I briefly explains the origins of ERISA's tax controls. Part II surveys ERISA's accomplishments and limitations in suppressing pension tax shelters. Part III describes later momentous developments to which ERISA pointed the way.

I. THE PENSION TAX DODGE

Since 1942, favorable income tax treatment of qualified plan savings has been conditioned on establishing that the plan's coverage and the contributions or benefits provided under the plan do not discriminate in favor of officers, shareholders, or highly compensated employees.[10] From the outset, however, the statutory nondiscrimination standards included the qualification that no plan shall be considered discriminatory merely because it excludes employees whose total compensation constitutes wages subject to social security payroll taxes, or because it provides a higher rate of contributions or benefits based on that part of an employee's compensation that exceeds the maximum amount of wages subject to the social security taxes.[11] Under those social security integration rules, a plan that covered only the high-paid segment of the workforce—that excluded all employees who earned less than the social security taxable wage base—could obtain favorable tax treatment.[12] Moreover, a corporation in the business of selling the services or talents of its sole employee could have a qualified plan covering only that employee even if the employee was also the corporation's principal or sole shareholder.[13] Accordingly, the nondiscrimination rules presented no bar to tax-deferred accumulations by one-person service corporations.

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10. *See* Internal Revenue Code of 1939, §§ 23(p)(1), 165(a) (1952) (repealed 1954); *see also* 1 J. S. SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS 1953–1939, at 1377, 2098 (1954); JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY 29–34 (2004).

11. *See* Internal Revenue Code of 1939, § 165(a)(5) (1952) (repealed 1954); *see also* 1 SEIDMAN, *supra* note 10, at 2099.

12. *See infra* notes 87–92 and accompanying text.

13. Rev. Rul. 72-4, 1972-1 C.B. 105; *see* Jim's Window Serv., Inc. v. Comm'r, 33 T.C.M. (CCH) 563 (1974). A corresponding rule applies today, but with the important limitation that all employees of commonly controlled trades or businesses and affiliated service groups are treated as employed by a single employer. I.R.C. §§ 410(b)(6)(F), 414(b), (c), (m) (2012).

And until ERISA took effect there was virtually no limit on the size of the tax-subsidized pension that could be paid to a shareholder-employee under a defined benefit plan.[14] Hence, in spite of the non-discrimination rules, it was frequently possible for a closely-held corporation to sock away huge amounts as qualified plan savings for its shareholder-employees. If kept within the vague and permissive bounds of "reasonable compensation," those amounts not only escaped the double tax on corporate profits, they also obtained tax deferral and, if paid as a lump-sum distribution on account of the separation from service or death of the employee, much of the distribution would be taxed as a long-term capital gain at only half of the tax rate applicable to other income.[15] Accordingly, the pre-ERISA pension tax shelter did not just achieve tax deferral,[16] it might convert ordinary income into capital gain, and on the death of a wealthy owner-employee, undistributed amounts were exempt from the estate tax![17]

This nearly-perfect qualified plan tax shelter did have some drawbacks. Foremost was the problem of limited access.[18] Because a

14. The pre-ERISA version of the limits on the employer's deduction for qualified plan contributions required that overall compensation be "reasonable" and, in the case of a defined benefit plan, be granted a current deduction for the normal cost of the plan plus an amount to amortize past-service credits. There was no restriction, however, on the total amount promised as a pension (retirement annuity), which amount determined the size of the normal cost and past-service liability. I.R.C. § 404(a)(1)(C) (1970) (amended 1974). In the case of a profit-sharing or stock bonus plan, annual deductible contributions were generally limited to 15% of the compensation otherwise paid or accrued during the year to all covered employees, but there was no limit on the extent of compensation considered for this purpose. *Id.* § 404(a)(3)(A). Consequently, the tax-deductible contribution to the account of a sole employee-shareholder who earned $1 million in salary could be as high as $150,000.

15. I.R.C. § 402(a)(2) (1970) (amended 1974), *id.* § 1202 (repealed 1986) (50% deduction for long-term capital gains, increased to 60% in 1978). The Tax Reform Act of 1969 generally limited capital gain treatment of lump-sum distributions to benefits accrued in plan years beginning before 1970. *Id.* § 402(a)(5) (amended 1974).

16. If certain conditions are satisfied, tax deferral under a qualified plan is financially equivalent to tax exemption of the investment income earned during the period of deferral. *See* ERISA PRINCIPLES, *supra* note 5, at 299 & n.43. The reduced tax rate available to lump-sum distributions meant that the pre-ERISA tax treatment of qualified plan savings was often much more favorable than outright tax exemption of all investment returns.

17. I.R.C. § 2039(c) (1970) (amended 1976; repealed 1986). The estate tax exclusion survived ERISA, but in 1976 it was made inapplicable to lump-sum distributions (which received favorable income tax treatment). In 1982 the excludible amount was limited to $100,000, and the gross estate exclusion for qualified plan benefits was finally repealed in 1984. *See* STAFF OF THE JOINT COMM. ON TAXATION, 97TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, at 288–89 (Comm. Print 1983); STAFF OF THE JOINT COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX REFORM ACT OF 1984, at 824–25 (Comm. Print 1984).

18. In addition, the IRS required plans sponsored by small, closely-held corporations to contain certain terms to forestall discrimination in favor of officers, shareholders, and highly

qualified trust must be for "the exclusive benefit of . . . employees or their beneficiaries,"[19] until 1963 partners or sole proprietors could not participate in a qualified plan even if they devoted their efforts to the business full-time, working alongside their common-law employees.[20] If the business was incorporated, such working owners were transformed, in the eyes of the law, into dual status shareholder-employees, and in their capacity as employees they could participate in a qualified plan of their corporate employer. Traditional ethical rules of many professions, such as doctors, lawyers, and accountants, prohibited practice in corporate form, however. That wall was breached by *United States v. Kintner*,[21] which held that a state

compensated employees. Two such prophylactic measures are noteworthy. First, the Service demanded inclusion of contractual rights to prompt preretirement vesting of accrued benefits so that rank-and-file employees, who typically have shorter tenure (higher turnover rate) than highly-paid managers, would not suffer differential forfeitures (discrimination in benefits actually paid by operation of extended service conditions). *See* Halperin, *Setting the Stage*, *supra* note 9, at 273 (five-year graded vesting at 20% per year often required); Isidore Goodman, Chief of the Pension Trust Branch of the Internal Revenue Service, Address Before the Association for Advanced Life Underwriting: Assured Retirement Benefits, Questions and Answers, Q&A–25 (Mar. 11, 1968), *in* ISIDORE GOODMAN ON QUALIFIED PENSION AND PROFIT-SHARING PLANS UNDER THE INTERNAL REVENUE CODE ¶ 19,043.21 (1975) [hereinafter SPEECHES BY ISIDORE GOODMAN] (stating that the required rate of vesting depends upon the facts of the particular workforce); Rev. Rul. 65-258 § 5(c), 1965-2 C.B. 94, 120; Bureau of Internal Revenue, Pension Trust Service Ruling No. 22 (Sept. 2, 1944), *reprinted in* GERHARD A. MUNCH, FEDERAL TAXATION OF INSURED PENSIONS, at App–110 (1976). *See also* Halperin, *Setting the Stage*, *supra* note 9, at 271 ("Isidore Goodman was the head of the pension section at [the IRS] at that point. CCH [Commerce Clearing House] used to print his speeches just like they were revenue rulings.").

Second, qualified defined benefit plans were required to contain provisions that could cut back the employer-provided benefits payable to any of the twenty-five highest-paid employees in the event the plan was terminated or such an employee's benefits became payable within ten years of establishment of the plan. Those provisions were required "to prevent the discrimination that may occur in the event of an early termination of the plan." Treas. Reg. § 1.401–4(c)(1). The cut-back rules responded to the concern that, if a defined benefit plan is not fully funded, retirement of highly compensated employees shortly after the plan is established may suck out all of the money, leaving non-highly compensated employees (NHCEs) holding an empty bag. If the plan were later terminated, NHCEs would have no protection, because the requirement of immediate vesting on plan termination (which became a qualification condition in 1963, I.R.C. § 401(a)(7) (1970) (amended 1974)), applies only "to the extent funded." In the pre-ERISA era a sponsor could limit its liability to contributions required under the funding rules, and could voluntarily terminate an underfunded plan. ERISA expressly preserved both the benefit cut-back rules and the requirement of vesting on termination. I.R.C. § 411(d)(2), (d)(3) (2012); ERISA § 203(c)(2), 29 U.S.C. § 1053(c)(2) (2012).

19. I.R.C. § 401(a) (introductory clause), (a)(2) (2012).

20. Section 401(c), which treats certain self-employed individuals (partners or proprietors performing services in the conduct of an unincorporated service business) as employees for purposes of the qualified plan rules, was added to the Code by the Self-Employed Individuals Tax Retirement Act of 1962, Pub. L. No. 87-792, § 2, 76 Stat. 809, and became effective for tax years beginning after December 31, 1962.

21. 216 F.2d 418 (9th Cir. 1954).

law partnership of practicing physicians could be endowed with organizational characteristics that would cause it to be classified as a corporation for tax purposes so that a qualified plan for the benefit of its "employees" could be adopted.

The Treasury responded in 1960 by revising its approach to the tax classification of unincorporated business organizations (i.e., the definition of an association taxable as a corporation), issuing the so-called "Kintner regulations," renowned for their strong bias in favor of partnership tax status.[22] This bias would return to haunt the Treasury, as it facilitated the widespread syndication of tax shelter limited partnerships during the 1970s and 1980s.[23] When Congress authorized coverage of the working owners of unincorporated businesses by legislation enacted in 1962 it subjected plans covering self-employed individuals (commonly known as "H.R. 10" or "Keogh" plans, from the bill number and name of its principal sponsor) to much stricter qualification requirements and limitations on deductible contributions to forestall abuses.[24] Those restrictions did not succeed in preventing highly-paid professional service providers from exploiting the pension tax shelter, because individual professionals and their trade associations lobbied state legislatures to permit them to incorporate their practices under special professional incorpora-

22. Treas. Reg. § 301.7701-2 (amended 1997), T.D. 6503, 25 Fed. Reg. 10928 (Nov. 17, 1960); 1 WILLIAM S. MCKEE ET AL., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS ¶ 3.06, at 3-53, 3-56 to 3-58 (3d ed. 1997).

> [T]here is no question that the proximate inspiration for the 1960 Regulations was to limit the availability of qualified pension benefits by narrowing the substantive scope of the association concept. Ironically, the 1960 Regulations did not accomplish their immediate purpose, but facilitated a massive expansion of activities that could be conducted without being subjected to the corporate tax regime. Rather than attacking the 1960 Regulations directly, professionals who desired the benefits of qualified corporate pension and profit-sharing plans persuaded the legislatures of nearly every state to enact legislation enabling them to incorporate under special professional corporation or association statutes.

Id. at 3-57.

23. MCKEE ET AL., *supra* note 22, at 3-53 ("This narrowing of the association concept did not achieve its end, but had the unintended consequence of making it much easier for passive investors to pool their funds in entities (state law partnership and limited liability companies (LLCs)) without subjecting the resulting income (or loss) to the corporate tax regime.").

24. *See supra* note 20. The additional stricter qualification requirements imposed on plans covering self-employed individuals were contained in the pre-ERISA version of I.R.C. §§ 401(a)(9), (a)(10), (d), (e), 404(a)(8), (a)(9), (e) (1970) (amended 1974). *See also* Isidore Goodman, Chief of the Pension Trust Branch of the Internal Revenue Service, Address Before the Western Pension Conference: The Mounting Volume of H.R. 10 Plans (Sept. 28, 1967), *in* SPEECHES BY ISIDORE GOODMAN, *supra* note 18, at ¶ 19,042.

tion laws.[25] As such, they could adopt corporate plans free of the limits imposed on plans covering the self-employed.[26]

Once high-income professionals could sponsor qualified "corporate" pension, profit-sharing, and stock bonus plans, revenue leakage from the pension tax shelter threatened to swell to a flood. The 1965 report of the President's Committee on Corporate Pension Funds recognized that special tax treatment encouraged the rapid growth of private pension plans, but concluded that existing tax law (despite its nondiscrimination rules and deduction limits) permitted many serious inequities, including "extremely large benefits for highly compensated employees" and unjustifiably lax standards governing social security integration.[27] This was the era of Stanley Surrey's leadership of the Treasury Department's tax policy staff, the development and unveiling of his withering critique of "tax expenditures," and the flowering of the comprehensive tax base debate.[28] Amidst that vibrant milieu, the danger to the fisc posed by qualified plans did not pass unnoticed, and yet when hearings were held on an early comprehensive pension reform bill in 1968, the Treasury testified in support of vesting, funding, and plan termination insurance requirements that would have been administered solely by the Labor Department, with no suggestion of necessary tax law changes.[29] Presumably, that position reflected a preference to keep additional social programs out of the tax code, combined with

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25. *See supra* note 22.

26. *See, e.g.*, United States v. Empey, 406 F.2d 157, 170 (10th Cir. 1969) (holding a law firm organized as Colorado professional service corporation to be a corporation for federal tax purposes and invalidating 1965 amendment to Kintner regulations designed to prevent professional service organizations from being classified as corporations).

27. PRESIDENT'S COMM. ON CORP. PENSION FUNDS, PUBLIC POLICY AND PRIVATE PENSION PROGRAMS, vii–viii, 11–13, 59–69 (1965). *See generally* WOOTEN, *supra* note 10, at 80–115; Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, *in* S. SPECIAL COMM. ON AGING, 98TH CONG., THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 8–10 (Comm. Print 98-221, 1984).

28. *See generally* STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES (1985); Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967); R.A. Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44 (1967); Joseph A. Pechman, *Comprehensive Income Taxation: A Comment*, 81 HARV. L. REV. 63 (1967); Charles O. Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR*, 81 HARV. L. REV. 1016 (1968); Boris I. Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032 (1967).

29. *Pension and Welfare Plans: Hearing Before the Subcomm. on Labor of the S. Comm. on Labor and Public Welfare*, 90th Cong. 275–80 (1968) (statement of Stanley S. Surrey, Assistant Secretary of the Treasury for Tax Policy). Daniel Halperin, then an attorney-advisor in the Office of Tax Policy, accompanied Surrey to the hearing. *Id.* at 275. *See also* Halperin, *Setting the Stage*, *supra* note 9, at 287 (Treasury favored drafting the pension reform bill so that it did not go before the congressional tax committees).

an expectation that future tax legislation would clamp down on pension tax abuses.

II. ERISA'S ANTI-ABUSE AGENDA

The prospect of a ready fix for pension tax abuses proved illusory. The Senate Finance Committee's version of the Tax Reform Act of 1969 included a provision that would have clamped down on pension savings for shareholder-employees of professional service organizations.[30] Any owner-professional was to be taxed currently on contributions made to the plan on his behalf insofar as they exceeded 10% of his compensation from the corporation or $2500, whichever was less. That stringent limit on pre-tax contributions was the same as the deduction limit for H.R. 10 plans, which would have applied if the professionals had not incorporated their practice.[31] The proposal met fierce opposition and was stripped from the bill by a floor amendment in the Senate.[32]

Despite the growing revenue hemorrhage from professionals' strategic use (some might call it abuse) of the qualified plan rules, ERISA was not meant to be tax legislation. The original comprehensive pension reform bill introduced by Senator Jacob Javits in 1967 would have been administered by an independent five-member commission similar to the Securities and Exchange Commission, and would have left the tax laws essentially untouched.[33] As noted earlier, the Johnson Administration put forward a labor law bill in 1968.[34] As late as the opening of the Ninety-third Congress in January 1973, the bipartisan pension reform bill sponsored by Senators Harrison Williams and Jacob Javits was exclusively a labor law proposal, to be administered by the Labor Department.[35] ERISA's dual or composite character—labor law and tax law—emerged out of a colossal political miscalculation. The Senate Education and Labor Committee's pension reform bill was poised for Senate passage late in the Ninety-

30. S. REP. NO. 91-552, at 270–72 (1969).

31. I.R.C. § 404(e)(1) (1970) (amended 1974).

32. *See* 119 CONG. REC. 30,376 (Sept. 19, 1973) (remarks of Sen. Thurmond), *reprinted in* 2 SUBCOMM. ON LABOR OF THE S. COMM. ON LABOR AND PUBLIC WELFARE, LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 1780 (Comm. Print 1976) [hereinafter ERISA LEGISLATIVE HISTORY].

33. S. 1103, 90th Cong. §§ 3, 4 (1967), 113 CONG. REC. 4653, 4654–55 (1967); 113 CONG. REC. 4659 (statement of Sen. Javits).

34. *See supra* note 29 and accompanying text.

35. *See* S. 4, 93d Cong. (bill as introduced, Jan. 4, 1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 93. As introduced, S. 4 was identical to the bill reported by the Senate Labor Committee in September 1972 (S. 3598, 92d Cong. (1972)). WOOTEN, *supra* note 10, at 193.

second Congress when, in autumn of 1972, the Senate Finance Committee—with the support of the Nixon Administration and the Chamber of Commerce—intervened to derail it.[36] Backlash from the press and the public was intense, and it quickly became clear that, in repentance for its transgression, the Finance Committee would have to climb aboard the pension reform train in the Ninety-third Congress.

The Senate Education and Labor Committee's bipartisan pension reform bill was promptly reintroduced as S. 4 when the Ninety-third Congress convened in January of 1973.[37] To stake its jurisdictional claim, the Finance Committee responded by introducing S. 1179, a tax-based pension reform bill, in March of 1973.[38] To atone for its earlier political sin, the tax bill called for minimum participation, vesting and funding standards, along with a termination insurance program. The bill also endorsed individual retirement accounts (IRAs, a Nixon Administration initiative) for workers who were not covered by a qualified plan, and enlisted them as the mechanism to provide pension portability via rollover IRA contributions.[39]

The Finance Committee's deliberations on S. 1179 also presented the opportunity to put a stop to pension tax abuses. The bill reported by the Finance Committee aimed to do just that, imposing additional qualification conditions and deduction limits on corporate plans covering "proprietary employees," defined as employees owning 2% or more of the employer's stock (actually or constructively) if the present value of their total accrued benefits exceeded 25% of the present value of accrued benefits of all active participants in the plan.[40] If that threshold was surpassed, limits were imposed on the amount of benefits that such proprietary employees could accrue under defined benefit plans, while deductible contributions to defined contribution plans were subject to the very low H.R. 10 plan

36. The story is ably told in WOOTEN, *supra* note 10, at 185–89. *Accord* Gordon, *supra* note 27, at 23 ("spurred on by a coalition of business groups and the administration, the Finance Committee gutted the bill of all its significant reforms, stating that it believed that coverage, vesting, funding and related provisions should continue to be dealt with by the tax committees of Congress"); William M. Lieber, *An IRS Insider's View of ERISA*, 65 TAX NOTES 751 (1994).

37. S. 4, 93d Cong. (as introduced, Jan. 4, 1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 93.

38. S. 1179, 93d Cong. (as introduced, Mar. 13, 1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 230; WOOTEN, *supra* note 10, at 190–91.

39. WOOTEN, *supra* note 10, at 195, 206.

40. S. 1179, 93d Cong. § 702 (as reported by the Finance Comm., Aug. 21, 1973) (proposed I.R.C. §§ 401(a)(12), (a)(13), (j), 412)), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 780, 1021–26, 1028–35.

limits.[41] The Finance Committee "concluded that the basic situation of certain proprietary-employees of closely-held corporations is so similar to that of self-employed people that they should generally be treated like self-employed people for pension purposes."[42] The proprietary employee limitation in S. 1179 "would have ended both the present stampede by many members of the medical and legal professions to incorporate to enjoy the substantial benefits provided under a corporate pension plan and the present tax discrimination against lawyers and doctors providing the same professional service without incorporating."[43]

Compromise between the Labor and Finance Committees led to ERISA's curious overlapping legislative standards (incorporated in both the labor and tax titles of the U.S. Code) and corresponding regulatory oversight. As part of that compromise, most of the tax matters addressed in S. 1179 were incorporated in S. 4 by amend-

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41. *Id.*; S. Rep. No. 93-383, at 119–25 (noting that state professional incorporation laws have been used to obtain the favorable tax treatment accorded corporate plans, that the Kintner regulations have failed to control that development, and that the enormous proliferation of professional corporations has had the effect of circumventing limitations which Congress intended to impose on persons who are essentially self-employed), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1063, 1187–93; WOOTEN, *supra* note 10, at 207 ("Finance proposed to apply the [revised H.R. 10 plan] limit to professional corporations, which were not subject to contributions limits under current law.").

42. S. REP. NO. 93-383, at 9 (1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, supra note 32, at 1063, 1077. *Accord id.* at 13–14, 29–30.

> The committee concluded that a limit on deductible contributions is essential in order to achieve equality of tax treatment under pension plans for the self-employed and corporate proprietary employees. The present action of the committee, in effect, represents the culmination of the consideration of similar provisions on a number of occasions in recent years. . . .
>
> An appropriate limitation on plan contributions on behalf of proprietary employees of closely held corporations is essential not only to equalize the tax treatment of plans of such proprietary employees with those of self-employed people but also in order to prevent high pensions for stockholder employees without significant costs being incurred for nonstockholding employees. Since in many instances, the firms in which such proprietary employees work have few regular employees, the requirement to finance nondiscriminatory benefits for the regular employees under qualified plans does not involve sufficient costs to limit the pension of the proprietary employees.

Id. at 29. *See also* 120 CONG. REC. 4292 (Feb. 26, 1974) (remarks of Rep. Ullman) (under smaller plans nondiscrimination rules do not impose practical cost limits on the amount of contributions or benefits for highly paid individuals), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 3408; 119 CONG. REC. 30,360 (Sept. 19, 1973) (remarks of Sen. Nelson) ("[O]n the question of discrimination—that is to say, that no employer in this pension field can grab a big bundle for himself and discriminate against his employees—I think the Senator should know that under the law a doctor can contract for secretarial and other services and avoid employing many employees."), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1747.

43. 119 CONG. REC. 30,132 (Sept. 18, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1680, 1713.

ment. There was one notable exception, however: the Finance Committee's proprietary employee provision—which subjected professional and closely-held corporations to the same limits on qualified plan savings for working owners as would be applied to self-employed partners and proprietors—triggered intense opposition from powerful lobby groups.[44] Russell Long, chairman of the Finance Committee, explained that "we heard so much protest and so much complaint from across the land, and so much expression of dissatisfaction addressed to Congress . . . that we did not think we could sustain it on the floor of the Senate."[45] Instead, the Committee proposed a $75,000 annual limit on the yearly pension that could be paid to a proprietary employee.[46]

The proposed pragmatic substitute, a $75,000 limit on tax-subsidized pensions for proprietary employees, was condemned by liberal reformers as a toothless tiger. (The purchasing power of $75,000 in 1973 is comparable to $400,000 in 2014.[47]) Senator Gaylord Nelson—who, as a member of both the Labor and Finance Committees, served as floor manager of the bill[48]—proposed an amendment to reduce the limit to $45,000 and apply it across-the-board to all corporate pensions, whether sponsored by professional or closely-held corporations or large publicly-traded companies. He explained that multiple pension

> tax preferences are justified because the private pension system as a whole supposedly provides for the retirement income of a substantial number of low income workers.

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44. *See* WOOTEN, *supra* note 10, at 213–15.

45. 119 CONG. REC. 30,357 (Sept. 19, 1973) (remarks of Sen. Long), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1739. Senator Long explained that the original proprietary employee limitations would have held incorporated law practices and incorporated medical practices to the same limits as self-employed lawyers and self-employed doctors, but while the Finance Committee thought that was equitable "there was a tremendous amount of protest against" it, and "[w]e were convinced we could not sustain that position." *Id.*, *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1740. *See also* 119 Cong. Rec. 30,378 (remarks of Sen. Bible) (reporting opposition to the "early proposal to extend the new self-employment limitations broadly to corporations raised widespread concern among small corporations and their professional advisers," and conveying comments from accountants and lawyers), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1784–85.

46. Amendment No. 497 to S. 4, 93d Cong. §§ 702, 704 (Sept. 17, 1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1498, 1523–37, 1542–46; WOOTEN, *supra* note 10, at 213–15.

47. *See* Bureau of Labor Statistics, *CPI Inflation Calculator*, http://www.bls.gov/data/inflation_calculator.htm.

48. WOOTEN, *supra* note 10, at 213.

> In practice, however, this is not always true. A corporation can have a qualified pension plan regardless of how few persons besides the owner it employs.
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> Lack of wide coverage is particularly true of professional corporations. In just the 4-year period of 1968 to 1971, the number of corporate tax returns filed by physicians and surgeons increased from 1,600 to 20,000, while the number of such tax returns filed by legal service firms rose from 158 to over 3,000. One-man professional corporations are common.[49]

While the rapid proliferation of professional corporations was symptomatic of tax abuse, Senator Nelson sought an across-the-board limitation because he felt that sound tax policy called for "a ceiling on the amount of pension that may be supported by tax deductible dollars."[50]

> [I]t is absurd to maintain that only by allowing highly paid corporate executives such lavish annual pensions will large corporations be willing to establish plans covering most of their workers. I believe that even the highest paid corporate executive would find some value in a much more modest annual pension. . . .
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> . . . .
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> . . . I do not consider this amendment to be the first step to tax reform, but rather the first step to sanity.[51]

"[I]ronically, it is likely to be the low income workers who are not covered by pension plans and whose taxes consequently must be increased to pay for the generous tax treatment afforded higher paid workers covered under pension plans."[52] The proposed cap on all corporate pensions sparked prolonged and vigorous debate.[53] The $45,000 cap was rejected, but in the end the Senate did vote to apply

49. 119 CONG. REC. 30,133 (Sept. 18, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1715.

50. 119 CONG. REC. 30,354 (Sept. 19, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1732.

51. 119 CONG. REC. 30,132 (Sept. 18, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1712, 1714.

52. 119 CONG. REC. 30,132 (Sept. 18, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1713.

53. 119 CONG. REC. 30,130–43, 30,354–62, 30,367–80 (Sept. 18–19, 1973), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1708–90; Lieber, *supra* note 36, at 751 (noting that limits on benefits and contributions was the most contentious issue during 1973 Senate consideration of S. 4).

the $75,000 limit across-the-board.[54] This, of course, was the genesis of I.R.C. § 415, which imposes the limits on the maximum amount of contributions or benefits that can be provided to any participant under a qualified plan.[55]

As a measure aimed at controlling the tax subsidy for private pensions, Code section 415 is one of the few tax provisions of ERISA that has no labor law counterpart. Still, it does not stand alone. ERISA contained three other important provisions directed at targeting and controlling the tax subsidy. Two of these tax shelter limitations drew little attention, while the third—which extensively revised the limits on H.R. 10 plans—pointed the way for the future.

A noncontroversial but enormously consequential tax control appeared in the guise of an innocuous tax code definition. The workforce aggregation rules of I.R.C. § 414(b) and (c)—which treat employees of all commonly controlled businesses, whether or not incorporated, as employed by a single employer—prevent easy evasion of the nondiscrimination rules by the simple expedient of segregating the workforce into distinct organizational units, such as a parent corporation that employs highly-paid managerial, technical, and professional employees, and a subsidiary that employs lower-paid production or service personnel. Absent the workforce aggregation rules, a generous plan limited to parent corporation employees could qualify for preferential tax treatment even though it accomplished little by way of retirement savings on behalf of rank-and-file workers.[56] The first tax-based pension reform bill reported out of the Finance Committee in the Ninety-third Congress included a forerunner to the workforce aggregation rules;[57] it was carried forward in subsequent bills virtually without comment.[58]

54. 119 CONG. REC. 30,360 (Sept. 19, 1973) (remarks of Sen. Nelson) ("[N]ow that the Senate has done its duty and taken care of the rich and affluent with the defeat of the last amendment, let us adopt this amendment that at least says you cannot raid the Treasury for any more money than it takes to pay a $75,000 a year pension.") *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1749.

55. The wisdom of I.R.C. § 415 as a matter of tax policy is debatable, because capping qualified plan contributions or benefits for highly compensated employees (HCEs) limits the tax subsidy that is available for redistribution to NHCEs by means of the qualified plan nondiscrimination rules. ERISA PRINCIPLES, *supra* note 5, at 343–47; Colloquy between David Cay Johnston and Daniel I. Halperin, *in* Panel Discussion, *Some New Ideas and Some New Bottles: Tax and Minimum Standards in ERISA*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 385, 402–04 (2014).

56. *See generally* ERISA PRINCIPLES, *supra* note 5, at 317–21.

57. S. 1179, 93d Cong. § 201(a) (as reported, Aug. 21, 1973) (proposed I.R.C. § 410(a)(3), on affiliated corporations), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 780, 835; S. REP. NO. 93-383, at 43 (1973) ("The committee, by this provision, intends to make it clear that the coverage and antidiscrimination provisions cannot be avoided by operating through sepa-

ERISA's other consensus restriction on qualified plan tax benefits was the termination of long-term capital gain treatment (then a 50% deduction) for lump-sum distributions. Although the details varied, all the tax-based pension reform proposals in the Ninety-third Congress provided that only pre-1974 accumulations would henceforth be eligible for capital gain treatment if received as a lump-sum distribution; post-1973 savings would be taxed as ordinary income, but would be eligible for some form of forward averaging.[59]

ERISA also extensively revised the tax qualification requirements and deduction limits applicable to plans covering self-employed individuals—H.R. 10 plans covering working owners of unincorporated businesses. One component of these changes involved a threefold increase in the annual limit on deductible contributions, raising it from the lesser of $2500 or 10% of earned income derived from the business to $7500 or 15% of earned income.[60] Congress hoped that the liberalization of deductible contributions would dampen the incentive of professionals and small-business owners to incorporate, thereby quelling the pension tax shelter problem.[61]

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rate corporations instead of separate branches of one corporation."), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1063, 1111.

58. Amendment No. 496 to S. 4, 93d Cong. § 201(a) (Sept. 17, 1973), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1271, 1286; H.R. 12481, 93d Cong. § 1015(a) (as reported by the Ways and Means Comm., Feb. 5, 1974) (adding aggregation of unincorporated businesses), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2394, 2448–49; H.R. REP. NO. 93-779, at 49–50 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2584, 2638–39; H.R. 12855, 93d Cong. § 1015(a) (as reported by the Ways and Means Comm., Feb. 21, 1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2924, 2978–79; H.R. REP. NO. 93-807, at 50–51 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 3115, 3170–71; H.R. 2, 93d Cong. § 1015(a) (as passed by the House, Feb. 28, 1974), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 3898, 4112–13; H.R. REP. NO. 93-1280, at 266 (1974) (Conf. Rep.), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4277, 4533.

59. *Compare* S. REP. NO. 93-383, at 137–46 (1973) (Finance Comm. report on S. 1179), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1063, 1205–14, *with* H.R. REP. NO. 93-1280, at 348–55 (1974) (Conf. Rep.), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4277, 4615–22.

60. *Compare* I.R.C. § 404(e)(1) (1970) (amended 1974), *with id.* (1982) (amended 1982); ERISA, Pub. L. No. 93-406, § 2001(a), 88 Stat. 829, 952 (1974).

61. Treasury Secretary George P. Schultz testified in favor of a substantial increase in the H.R. 10 plan deduction limit: "We think that if something like this isn't done, we will provide a terrific incentive to incorporate. There is no particular reason why we should force self-employed individuals to incorporate just to get this particular tax benefit." *Private Pension Plan Reform: Hearings Before the Subcomm. on Private Pension Plans of the S. Comm. on Finance*, 93d Cong., pt. I, at 347 (1973). *See* S. REP. NO. 93-383, at 120 (1973) (observing that a substantial increase in deductible contributions for the self-employed is justified in part by concern that present law creates substantial incentive to incorporate), *reprinted in* 1 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1063, 1188; H.R. REP. NO. 93-807, at 112 (1974) (same), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 3115, 3232; 120 CONG. REC. 29,202–03 (Aug. 20, 1974) (remarks of Rep. Broyhill) (noting that the "need for increases in the limitations on

The more generous tax subsidy of retirement savings for the self-employed was accompanied by additional anti-abuse rules. Post-ERISA, plans covering the self-employed could take into account only the first $100,000 of annual compensation, and excess contributions were deterred by an excise tax penalty instead of simply being nondeductible.[62] The compensation limit provided an essential link between the ban on discrimination in contributions or benefits (in particular, the rule that contributions or benefits that constitute a uniform proportion of compensation are not discriminatory) and the cap on the amount of tax-favored savings that could be provided to working owners. Without such a cap the plan could set aside the maximum allowable tax-subsidized savings for the owner by promising to contribute 0.5% of his $1.5 million earned income ($7500), but this uniform contribution rate yields a trivial contribution for low- and middle-income employees, and consequently technical compliance with the nondiscrimination rule would accomplish no significant redistribution.[63] The excise tax eliminated the advantage (tax deferred investment earnings) of deliberately contributing amounts that exceeded the deduction limit, and thereby cabined the subsidy.

How effective were ERISA's tax shelter constraints? It is hard to say. ERISA's enactment triggered an upsurge in plan terminations, but the extent to which employers were closing down abusive pension tax shelters cannot be disentangled from responses to prospective cost increases caused by ERISA's worker protective initiatives (such as the prohibition of certain age- and service-based participation conditions, the minimum vesting standards, and the termination insurance regime). During an oversight hearing in 1977 Senator Jacob Javits, the leading advocate of comprehensive pension reform and a principal sponsor of ERISA, said "we are very worried about plan terminations . . . . Is this an epidemic or is it simply the pruning

Keogh plans was occasioned by the lack of limitations heretofore in existing law relative to corporate employees" which disparity "has occasioned the widespread proliferation of the so-called professional corporations"), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4684.

62. ERISA § 2001(c), (f), Pub. L. No. 93-406, 88 Stat. 829, 952–53, 955–57 (1974) (adding I.R.C. §§ 401(a)(17) and 4972).

63. *See* ERISA PRINCIPLES, *supra* note 5, at 344; 120 CONG. REC. 29,948 (Aug. 22, 1974) (remarks of Sen. Curtis) ("By requiring the employer to figure his own contribution on the basis of not to exceed $100,000, his contribution of $7,500 would amount to 7½ percent. This new provision would then mean that his contribution for his employees would have to be 7½ percent of their salary" rather than 3%, if the employer could base his contribution on his full $250,000 of earned income.), *reprinted in* 3 ERISA Legislative History, *supra* note 32, at 4786.

off of plans where the promise could not have been performed any-how?"[64]

In hearings on plan terminations the following year, the director of the Pension Benefit Guaranty Corporation (PBGC) testified that in the three-and-one-half year period after ERISA's enactment almost 18,500 defined benefit plans were terminated, but those terminations affected only about 1% of defined benefit plan participants. That was because the average terminating plan had only twenty-three participants, and half of them had fewer than seven participants.[65] The IRS reported that in the three calendar years following enactment (1975 through 1977) its records showed that 21,600 defined benefit plans had terminated along with 25,000 defined contribution plans, but approximately another 130,000 plans had neither applied for a determination letter nor responded to IRS surveys.[66] About 500,000 plans had been treated as qualified at some point prior to ERISA, which suggests that somewhere between 10% and 35% of preexisting plans disappeared.[67]

Many shutdowns were attributed to business conditions; some were replaced by model plans that satisfied the requirements of the new law. Some sponsors cited the burdens of ERISA as a causal factor, but IRS data did not distinguish which aspects of the statute were troublesome.[68] Daniel Halperin, then Treasury Tax Legislative Counsel, seems to have calmed congressional anxiety by putting the post-ERISA termination surge in perspective:

> It is obvious that the greater the tax benefits you offer and the fewer restrictions that you put on the kinds of plans that people can have, the more plans we will have, but the diffi-

64. *Oversight of ERISA, 1977: Hearings Before the Subcomm. on Labor of the S. Comm. on Human Resources*, 95th Cong. 536 (1977) (statement of Sen. Jacob Javits).

65. *Individual Retirement Accounts and IRS Plan Termination Survey: Hearings Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 95th Cong. 3, 5 (1978) (statement of Matthew M. Lind, Executive Director, Pension Benefit Guaranty Corporation).

66. *Id.* at 14–15 (statement of Alvin D. Lurie, Assistant Commissioner, Employee Plans and Exempt Organizations, Internal Revenue Service).

67. *Id.* at 30 (statement of Rep. J.J. Pickle, Member, H. Comm. on Ways and Means). Apparently, many of the 130,000 non-responding plans may have been discontinued long before ERISA was enacted because the IRS never purged its files. *Id.* at 36 (statement of Fred Ochs, Director, Employee Plans Division, Internal Revenue Service). If so, the proportion of ERISA-induced terminations was probably closer to the low end of the range.

68. *Id.* at 33 (colloquy between Rep. Richard Gephardt and Alvin D. Lurie); *accord id.* at 10–11 (colloquy between Rep. Richard Gephardt and Matthew M. Lind); *id.* at 46 (statement of Rep. J.J. Pickle) ("We must accept as reality that fact that upward of 100,000 plans will have been lost, and we don't know whether it is just ERISA or a combination of circumstances.").

> culty is that they won't necessarily be the plans that you want.
>
> You may end up with plans that don't further any social goal. Perhaps I have a jaded view on this, but I spent a number of years in private practice and I drafted a large number of plans which gave extensive tax benefits to the owners of the business and very little in the way of retirement security to the rank and file employees, and if ERISA causes those kinds of plans to terminate, I am not sure that there is a great loss in terms of the security of the rank and file employees.
>
> . . . .
>
> The numbers of plans terminated is not in itself necessarily a detrimental result of the statute. One had to expect ERISA to cause some plans to terminate. Let's hope it was the right ones rather than the wrong ones.[69]

Shortly after this hearing the General Accounting Office (GAO) released a report on a random sample of defined benefit plan terminations occurring between September 1974 and June 1976. Some 93% of the plans surveyed had fewer than one-hundred participants, and on average the sponsors of these plans employed forty-seven full-time employees of which only fifteen were participating in the terminated plan.[70] The GAO found that, while 53% of the plans named ERISA as a major reason for termination, these "terminating plans generally did not meet ERISA's minimum participation and vesting requirements."[71] The report concluded that the adverse impact of the large number of terminations was not as great as it appeared, both because pension coverage was continued under another plan in about 41% of the cases, and because the increased costs imposed by ERISA "are necessary to make sure that employees have

69. *Id.* at 47 (statement of Daniel I. Halperin, Tax Legislative Counsel, U.S. Department of the Treasury). *See* Remarks of Henry Rose, *in* Panel Discussion, *Setting the Stage: History Before the Ninety-Third Congress*, *in* Symposium: *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 265, 277 (2014) ("In Congress there were committee hearings on the issue [of post-ERISA plan terminations] at the time that just really went nowhere.").

70. U.S. GEN. ACCOUNTING OFFICE, HRD-78-90, EFFECT OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT ON THE TERMINATION OF SINGLE EMPLOYER DEFINED BENEFIT PENSION PLANS 1 (1978). A preliminary version of this GAO report appears in *National Pension Policies: Private Pension Plans: Hearings Before the Subcomm. on Retirement Income and Employment of the H. Select Comm. on Aging*, 95th Cong. 179 (1978) [hereinafter *National Pension Policies*]; *see id.* at 4 (testimony of Gregory J. Ahart, Director, Human Resources Division, General Accounting Office).

71. U.S. GEN. ACCOUNTING OFFICE, *supra* note 70, at 19.

an equitable opportunity to participate in the plan and that participants receive earned pension benefits."[72] "[I]t is significant that even though there have been a lot of plan terminations, these have been small plans which have terminated. Since ERISA was enacted there are three times as many participants that have been brought under coverage of the plan termination insurance program as have been affected by the plan terminations."[73] Hence it seems that, to use Daniel Halperin's terms, the right plans were terminated. Even the GAO study, however, was not specific enough to sort out the extent to which the tax shelter limitation aspect of ERISA contributed to plan closures.[74]

III. UNFINISHED BUSINESS

The tax shelter limitation elements of ERISA were path-breaking, but they were also half measures. Some were understood as temporizing. Yet ERISA clearly foreshadowed several fundamental shifts in the qualified retirement plan tax regime that would play out over the period from 1974 through 1986.

A. The Close Corporation Pension Tax Shelter

The maximum-amount rules of I.R.C. § 415 capped the pension tax shelter but hardly eliminated it. If Congress thought that the liberalized allowance for H.R. 10 plans would quell the wave of professional incorporation and limit abuse by closely-held corporations, it was sorely mistaken. Congress abandoned the distinction between corporate-sponsored plans and plans of unincorporated businesses covering self-employed individuals in 1982. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) repealed some of the restrictive rules governing H.R. 10 plans, including the lower limits on contributions and benefits and the prohibition on integration with social security.[75] On the other hand, the minimum-distribution rules of I.R.C. § 401(a)(9)—which limit the duration of tax deferral and target the tax subsidy on retirement income, ostensibly to avoid tax-subsidized intergenerational wealth transfers—were extended to all

72. *Id.* at 29–30.

73. *National Pension Policies*, *supra* note 70, at 38 (testimony of Charles Skopic, Deputy Executive Director, Pension Benefit Guaranty Corporation).

74. *See* U.S. GEN. ACCOUNTING OFFICE, *supra* note 70, at 16–17 (listing other ERISA factors reported as contributing to terminations, but not including pension tax shelter limitations).

75. H.R. REP. NO. 97-760, at 621 (1982) (Conf. Rep.), *reprinted in* 1982 U.S.C.C.A.N. 1190, 1393.

qualified plans.[76] The rest of the special rules for H.R. 10 plans were made applicable to plans sponsored by either corporate or noncorporate employers which primarily benefit "key employees," a suspect group focused on employee owners.[77] Legislative parity in the treatment of plans sponsored by corporate and noncorporate employers was accompanied by temporary tax relief for corporations choosing to liquidate.[78]

B. Integration as Exclusion of the Rank and File

Well before 1974, many observers viewed IRS standards on acceptable coordination between qualified plans and social security as lax to the point of being scandalous. The 1965 Cabinet Committee report criticized the integration rules as unfairly giving the employer credit for social security benefits that were actually paid for by employee contributions.[79] During Senate debate on pension reform in 1973, the existing integration rules were criticized by William Hathaway and Gaylord Nelson, the latter pithily observing that "[p]ension benefits given to low-paid employees as an abstraction are taken away in the fine print of the income tax code."[80] The House Ways and Means Committee noted that "the objective of the Congress in increasing social security benefits might be considered to be frustrated to the extent that individuals with low and moderate incomes have their private retirement benefits reduced as a result of the integration procedures," but the report went on to register concern that elimination of integration "could substantially increase the cost of financing private plans."[81] Ways and Means called

76. *Id.*; *see* ERISA PRINCIPLES, *supra* note 5, at 353–55. TEFRA also capped the gross estate exclusion for employer-derived qualified plan benefits at $100,000; it was repealed entirely in 1984. *See supra* note 17 and accompanying text.

77. *See* H.R. REP. NO. 97-760, *supra* note 75, at 623–31. In conjunction with the 1986 revision of the nondiscrimination rules and social security integration standards, the I.R.C. § 401(a)(17) compensation limit was extended to all qualified plans. *See supra* note 64 and accompanying text. The penalty tax on nondeductible contributions, I.R.C. § 4972, was also extended to all qualified plans in 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1131(c)(1), 100 Stat. 2085, 2476.

78. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 247, 96 Stat. 324, 525–26; H.R. REP. NO. 97-760, *supra* note 75, at 634.

79. PRESIDENT'S COMM. ON CORP. PENSION FUNDS, *supra* note 27, at 62–63.

80. 119 CONG. REC. 30,133 (Sept. 18, 1973) (remarks of Sen. Nelson), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1716; 119 Cong Rec. 30,125 (Sept. 18, 1973) (Sen. Hathaway observes that "I do not believe it is very equitable to allow the employer to count as a contribution for the employee's plan whatever he is now paying toward that employee's social security."), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 1696.

81. H.R. REP. NO. 93-779, at 29 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2618.

for more study and a two-year moratorium on further integration.[82] The ERISA conference report tried to go further, generally prohibiting plans from taking into account post-1971 increases in social security taxes and benefit levels before July 1, 1976.[83] This integration stand-still triggered protests and lobbying by plan sponsors, and had to be withdrawn by concurrent resolution.[84]

The status quo on social security integration was untenable, however. Qualified plans could exclude from participation employees earning less than the maximum wages subject to social security payroll taxes, provided that higher-paid participants' contributions or benefits were based only on the portion of their compensation that exceeded the maximum, and provided that the rate of contributions or benefits earned on such excess compensation was kept within prescribed limits.[85] Dramatic increases in the social security taxable wage base during the 1970s and 1980s meant that more and more moderate-income workers saw all of their wages or salary become subject to social security taxes, with the result that those workers could be excluded under the prevailing integration rules.[86] This created the very real prospect that plans covering only highly-paid managers might be deemed nondiscriminatory, and thus qualified to receive preferential tax treatment![87] Under that state of affairs, integration makes a mockery of the nondiscrimination rules—they would force no redistribution. In the years following ERISA's enactment, the Treasury urged Congress to correct this situation,[88] but the problem was allowed to fester until the social security integration standards were comprehensively revised in 1986.[89]

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82. *Id.*

83. H.R. REP. NO. 93-1280, at 131, 280–81 (1974) (Conf. Rep.), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4277, 4405, 4547–48; WOOTEN, *supra* note 10, at 268.

84. 120 CONG. REC. 29,202, 29,218 (Aug. 20, 1974) (remarks of Rep. Ullman), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4683, 4730.

85. ERISA PRINCIPLES, *supra* note 5, at 332. The applicable limits were based on IRS approximations of social security contribution and benefit rates. The logic and pre-ERISA historical development of the integration rules is explained by Isidore Goodman, Chief of the Pension Trust Branch of the Internal Revenue Service, Address Before the Annual Meeting of the American Society of Pension Actuaries: Integrating Pension and Profit-Sharing Plans for Tax Qualification (Oct. 18, 1969), *in* SPEECHES BY ISIDORE GOODMAN, *supra* note 18, at ¶ 19,049.

86. ERISA PRINCIPLES, *supra* note 5, at 333.

87. *Id.* at 332–33.

88. Top Treasury tax policy officials in the Carter Administration explained the problem and urged prompt legislative action. *See National Pension Policies*, *supra* note 70, at 43–50 (statement of Daniel I. Halperin, Tax Legislative Counsel, Office of the Assistant Secretary of Treasury for Tax Policy).

89. I.R.C. § 401(*l*) (2012). Although the fix was not adopted until 1986, the current integration rules largely follow the solution recommended by Daniel Halperin in 1978. For policy cri-

C. CODAs: Tax Shelters for Everyone

Another question that surfaced during congressional deliberations was whether contributions authorized by an individual employee under a cash-or-deferred arrangement (CODA) should be classified as after-tax employee contributions or pre-tax employer contributions. In 1972 the IRS issued proposed regulations that invoked an expansive notion of the constructive receipt doctrine.[90] That proposal threatened to require elective contributions to be included in the employee's gross income when earned, causing them to be classified as after-tax employee contributions, greatly reducing the tax savings offered by the plan. Recognizing that the IRS proposal raised major issues of tax policy, the Ways and Means Committee observed that "[t]he basic question is the extent to which employees should be allowed to convert what would otherwise be a nondeductible employee contribution to a retirement plan to tax-deferred employer contributions on their behalf."[91] The tax-writing committee recognized that the results of individual elections would likely mean that many employees would not be covered and its report showed an awareness that elective reductions in take-home pay were apt to yield a pattern of deferral favoring highly-paid employees.[92] Congress concluded that difficult policy issues required further study, and so ERISA imposed a temporary freeze of the status quo, prohibiting new regulations from being applied to existing plans before January 1, 1977, but providing that contributions made at the employee's option under plans not in existence on June 27, 1974, would be treated as after-tax employee contributions.[93]

It is hard to overstate the danger to the income tax that unregulated CODAs would present. Before ERISA, CODAs were ordinarily associated with annual bonus programs to which a corporate employer committed a specified portion of its profits, giving each employee an election either to receive his share of the bonus in cash at

tiques of the post-1986 approach to integration, see Nancy J. Altman, *Rethinking Retirement Income Policies: Nondiscrimination, Integration, and the Quest for Worker Security*, 42 TAX L. REV. 433, 498 (1987) and Patricia E. Dilley, *The Evolution of Entitlement: Retirement Income and the Problem of Integrating Private Pensions and Social Security*, 30 LOY. L.A. L. REV. 1063 (1997).

90. *See* 37 Fed. Reg. 25938 (1972).

91. H.R. REP. NO. 93-779, at 38 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2584, 2627.

92. *See* H.R. REP. NO. 93-779, at 140–43 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 2584, 2729–32. *Accord* H.R. REP. NO. 93-807, at 142–45 (1974), *reprinted in* 2 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 3115, 3262–65.

93. ERISA § 2006, Pub. L. No. 93-406, 88 Stat. 829, 992–93; H.R. REP. NO. 93-1280, at 355–56 (1974) (Conf. Rep.), *reprinted in* 3 ERISA LEGISLATIVE HISTORY, *supra* note 32, at 4277, 4622–23.

year end or have it deferred under a profit-sharing plan for distribution at a later date.[94] If CODAs could instead be funded by wage- or salary-reduction contributions, and if the results of individual deferral elections were not constrained by nondiscrimination tests, there would be no stopping point.[95] By adopting a profit-sharing or stock bonus plan that included a CODA, an employer could put a framework in place that would function as a sort of turn-key "master tax shelter"—a tax deferral mechanism available to every employee and independently exercisable in whatever amount best suited her individual financial and tax circumstances. Many large companies had payroll deduction plans in place that allowed workers to purchase U.S. savings bonds by wage withholding.[96] CODAs presented a superior alternative: an optional tax-shelter purchase program. Appreciate that this prospect came into view in the early 1970s, just as the phenomenon of syndicated limited partnership tax shelters (designed to invest in oil and gas, depreciable real estate, farming, movie production, or other ventures yielding front-loaded deductions) was beginning to spin out of control, posing a very grave threat to federal revenues.[97] Left uncontrolled, CODAs could become the Treasury's worst nightmare: the prospect that large employers could, at little cost, put in place individually-customizable, low-risk tax shelters for everyone!

Instead, ERISA imposed a cease-fire-in-place which prevented a rush to institute new cash-or-deferred arrangements that might claim ongoing entitlement to pre-1972 treatment (a right to be grandfathered under any new approach). The CODA rules enacted in 1978 did indeed address the difficult issue of applying coverage and amount nondiscrimination principles to elective contribution

94. *See, e.g.*, Treas. Reg. § 1.401-3(c) (as amended in 1991); Rev. Rul. 56-497, 1956-2 C.B. 284; Richard Rubin & Margaret Collins, *You Can Thank or Blame Richard Stanger for Writing 401(k)*, BLOOMBERG (Feb. 3, 2014, 5:00 AM), http://www.bloomberg.com/news/2014-02-03/you-can-thank-or-blame-richard-stanger-for-writing-401-k-.html ("[Pre-ERISA CODAs] typically covered bonus payments, not a choice about deferring a portion of regular salary.").

95. Before ERISA, coverage and amount nondiscrimination tests were applied to CODAs by assessing the actual pattern of deferrals (results of individual elections) using a discretionary standard. *E.g.*, Rev. Rul. 56-497, 1956-2 C.B. 284; Harwood Assocs., Inc. v. Comm'r, 63 T.C. 255, 261–67 (1974).

96. Savings bonds accrue tax-deferred interest, but are bought with after-tax income. *See* I.R.C. § 1272(a)(2)(B) (excepting U.S. savings bonds from current inclusion of original issue discount).

97. The committee reports and hearings relating to the "limitation of artificial losses" under the Tax Reform Act of 1976 (the legislative background of what became the at-risk rules of I.R.C. § 465) are replete with descriptions of the threat posed by syndicated tax shelters to the progressive income tax. *See, e.g.*, H.R. REP. NO. 94-658, at 25–85 (1975); S. REP. NO. 94-938, pt. 1, at 45–91 (1976).

programs.[98] The explosive growth of CODAs—now commonly called 401(k) plans—over the past three decades is attributable to a number of factors, including global economic and labor market changes.[99] The tectonic shift from traditional defined benefit plans to 401(k) profit-sharing plans offers no clear indicator of any policy mistake in the CODA rules. Nevertheless, CODAs—which now commonly call for participant-directed investment decision-making[100]—surely facilitated the shift to a brave new world of do-it-yourself retirement savings programs that we grabble with today.

CONCLUSION

A common theme emerges from this brief historical sketch of ERISA's tax controls. The qualified plan rules, as they stood prior to ERISA, granted a virtually uncontrolled tax subsidy. It was almost an honor system. (Essentially, tax benefits were disbursed on faith, like the friend who, too drunk to reckon, hands over a wad of cash to pay the bar tab, simply imploring, "Don't hurt me.") In that era, the tax preference accorded qualified plans was frequently excessive and poorly targeted. The nondiscrimination rules, which had been enacted in 1942 to control abuse, were still rudimentary and hence were easily evaded by closely-held corporations. In that setting ERISA was watershed legislation and not just in its worker-protection guise. The provisions of ERISA Title II that have no labor law worker-protection counterpart—ERISA's tax controls—set Congress to work reining in the qualified plan tax subsidy[101] and transforming the nondiscrimination rules from ham-fisted anti-abuse rules into the complex, covert (and imperfect) redistribution mechanism we have today.[102]

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98. I.R.C. §§ 401(k), 410(b)(6)(E) (2012); *see generally* ERISA PRINCIPLES, *supra* note 5, at 296–98, 303–11, 339–43. For background on the development of section 401(k) in 1978, see Rubin & Collins, *supra* note 94.

99. For a graphical view of the rise of 401(k) plans, see PETER J. WIEDENBECK & RUSSELL K. OSGOOD, CASES AND MATERIALS ON EMPLOYEE BENEFITS 71–73 (2d ed. 2013).

100. *See* ERISA § 404(c), 29 U.S.C. § 1104(c) (2012); ERISA PRINCIPLES, *supra* note 5, at 136–52.

101. *See generally* ERISA PRINCIPLES, *supra* note 5, at 343–55. The key determinants of the amount of the qualified plan tax subsidy, apart from the participant's income tax rate, are the amount deferred and duration of deferral. As explained earlier, see *supra* text accompanying notes 47–55, ERISA capped the amount of contributions or benefits that can be provided under a qualified plan. I.R.C. § 415 (2012). Subsequent legislation constrained the duration of deferral, both by tightening the limits on deductible contributions, and by the 1986 extension of the required minimum distribution rules to all qualified plans. *See id.* §§ 404(a), 401(a)(9), 404(a)(2).

102. *See generally* ERISA PRINCIPLES, *supra* note 5, at 296–98, 303–11. The pre-ERISA development of the tax code's nondiscrimination rules is reviewed in Isidore Goodman, Chief of

the Pension Trust Branch of the Internal Revenue Service, Address Before the Conference of Pension Actuaries: Salaried-Only Pension and Profit-Sharing Plans (Oct. 5, 1970), *in* SPEECHES BY ISIDORE GOODMAN, *supra* note 18, at ¶ 19,055.