Income-Tax Treatment of Old-Age Pensions and Contributions Here and Abroad

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WHEN INTERNATIONAL comparisons of the economic impact of social security programs in different countries are made, consideration is not usually given to the income-tax treatment of benefits and contributions. Yet the tax treatment of these items may frequently affect significantly both the adequacy of the benefits being paid and the burden falling on the contributors who finance them. The income redistribution aspect of a program may also be significantly altered by the tax treatment accorded benefits and contributions. Special international interest in the subject is spurred by the fact that fairly large sums of money are now being paid by the social security systems of some countries as benefits to residents of other countries, where they may receive different income-tax treatment than in the country of origin.

SCOPE OF ANALYSIS

This article presents the results of a study of available information on the income-tax treatment of benefits and contributions under old-age pension programs in more than 20 countries. The information has largely been derived from secondary sources but has been verified to the extent possible by consulting the income-tax and social security laws of the countries involved.

It should be noted that a country's treatment of pensions and contributions is not always expressly dealt with either in the income-tax statute or in its social security law. Sometimes an administrative regulation or circular issued by the tax authorities determines the tax treatment. As a result, it is sometimes difficult to obtain definitive information for particular countries.

Types of Pensions

This study covers the income-tax treatment of the basic old-age pensions payable under general social security programs and of the contributions paid by insured persons to finance these benefits. The pensions covered usually take the form of social insurance benefits under contributory programs. Those paid under the universal pension programs of some countries to every aged citizen or permanent resident are, however, also included. Most countries pay "graduated pensions," relating the pension amount to the earnings on which contributions were paid; others provide for the payment of flat pensions. In a few instances, the pension amount combines a flat pension and earnings-related benefits.

The pension programs discussed here are generally financed through contributions payable by insured persons and their employers, which in a number of instances are supplemented by a national government subsidy financed from general revenues or from earmarked income taxes or sales taxes. Provincial or municipal governments also contribute toward the financing of pension programs in some instances. Contributions by insured persons are given primary attention here. In a majority of the countries covered, these are employment-related contributions, typically amounting to a fixed percent of covered earnings. In some countries, however, they are equal to a fixed amount a week for each person (sometimes with different amounts applicable to different categories of workers) that does not vary with wages. In a few other countries, they are made in the form of an income tax, typically equal to a fixed percent of net taxable income.

The present study analyzes the tax treatment of only those old-age pensions that are paid under general social security programs. It does not deal with old-age pensions provided under special systems or for civil servants. It does not cover other social security branches, since the tax treatment of contributions and benefits under the other branches paying cash benefits—sickness insurance benefits or family allowances, for example—differs extensively from program to program and from country to country. "Early" retirement benefits (actuarially reduced benefits paid before the normal pensionable age) are not dealt with

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specifically here, though it may be assumed that their tax treatment will generally be the same as that for regular retirement pensions. The analysis is also limited to the income-tax treatment of contributions paid and pensions received by persons previously employed by others.

Old-age assistance paid to persons at normal retirement age has been included in this presentation only where such assistance payments constitute the principal old-age pension program (as in Australia) or where they are an integral part of old-age pensions under social insurance or universal pension programs (as in Denmark). The purpose of old-age assistance programs is usually to help the indigent aged, rather than to provide old-age pensions for all or most of the working population regardless of current income. Old-age assistance pensions are usually subject to a means test and by definition are therefore paid mainly to persons whose other income, if any, is so small that the amount of the pension would generally not be sufficient to bring them into an income bracket requiring the actual payment of taxes under the personal income tax. Since old-age assistance programs are typically financed from general revenues, no question arises regarding the income-tax treatment of any contributions financing them.

Types of Income Taxes

Each of the countries covered in the study has a national personal income tax and a national corporate income tax. The countries differ considerably, however, in the extent of their reliance on either or both of these taxes as a source of their total tax collections. They differ also in the range of their rate structures (particularly under the personal income tax) and in the effective progressivity of their personal income tax (which depends on the definition of taxable income as well as on exemptions, deductions, and tax rates).

Only the tax treatment of social security under national income taxes is considered here.[1] In most of the countries, these taxes are far more significant than the income taxes levied by any provincial or local governments in terms of total revenue, range of rates, and overall effect on individual taxpayers. Exceptions exist in Norway and in Switzerland, where income taxes levied by governments below the national government level can, for the lower income groups, be more significant than national income taxes in terms of their incidence or their specific impact on the tax treatment of old-age pensions.

[1] For a discussion of the provisions of State income tax laws in the United States as they relate to social security benefits and contributions, see pages 18–19 of this *Bulletin*.

SUMMARY OF FINDINGS

The results of the study are summarized schematically in the accompanying table, which indicates for 22 foreign countries and the United States whether old-age pensions must be included in taxable income under the personal income tax and whether social security contributions made by insured persons under old-age pension programs are deductible from taxable income under the personal income tax. At the end of this section of the article, a brief description of the old-age pension system in each country and its sources of funds is given, as well as a description of the tax treatment applicable to old-age pensions and contributions.

Tax treatment of old-age pensions and contributions under the personal income tax of 23 countries

Country	Pensions included in taxable income [1]		Contributions deductible from taxable income	
	Yes	No	Yes	No
Australia		X	(2)	(2)
Austria	X		X	
Belgium	X		X	
Canada	X		(3)	(3)
Denmark	X		X	
Finland	X		X	
France	X		X	
Germany	X		X	
Greece	X		X	
Ireland	X		X	
Israel	X			X
Italy		X	X	
Japan	X		X	
Luxembourg	X		X	
Netherlands	X		X	
New Zealand	X			X
Norway	X		X	
Portugal	X		X	
Spain		X	X	
Sweden	X		X	
Switzerland	X		X	
United Kingdom	X		X	
United States		X		X

[1] Some countries require the inclusion of only a part of the total pension amount in taxable income. The summary for each country contains a more detailed description of such treatment where it applies.

[2] Not applicable since financed entirely from general revenues.

[3] Wage-related employee contributions under the old-age insurance program are deductible under the personal income tax, but the earmarked income tax that helps to finance the universal old-age pension program is not a deductible allowance under the regular income tax.

The table shows that a great majority of these countries require old-age pensions to be included in taxable income under the personal income tax. Similarly, in most of the countries social security contributions may be treated as a current deduction from taxable income under the personal income tax. Such tax treatment is completely opposite from the practice followed in the United States, where Treasury regulations provide that old-age pensions need not be included in taxable income and that employee contributions may not be deducted from taxable income.

Most of these countries seem to follow a rule that links the treatment under the personal income tax for old-age pensions with that for employee contributions. Thus, in countries where the pension must be included in taxable income, the employee contribution is usually deductible from taxable income. Four countries form an exception to the rule: In Israel and New Zealand, old-age pensions must be included in taxable income though contributions are not deductible; in Spain, the basic social security law exempts pensions from the income tax even though employee contributions are deductible; and in Italy, old-age pensions paid by the major social insurance institution are (by regulation) exempted from income tax even though social security contributions are deductible from taxable income. In France, old-age pensions must in principle be included in taxable income and contributions are deductible; the tax administration has, however, by administrative action exempted from the income tax those persons whose pensions do not exceed a certain amount and whose total resources do not exceed a given figure.

Provisions in Individual Countries

In order to provide some basic information on the tax treatment of old-age pensions, a brief summary has been prepared for each country covered in the study, indicating the nature of the old-age pension system and its sources of funds, as well as the treatment of old-age pensions and social security contributions under the personal income tax. It should be kept in mind that the information in the country summaries is strictly applicable only to the general *old-age* pension program. In the case of Germany, for instance, "no government subsidy" refers only to the old-age pension program and not to the closely related survivors' and disability pension program.

Australia

Old-age pensions take the form of assistance pensions (subject to a means test) and are financed entirely from general revenue funds. The pensions are specifically exempt under the personal income tax.

Austria

Graduated old-age pensions are provided through social insurance. They are financed through equal contributions payable by employees and employers (fixed percent of covered earnings) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income as a special allowance (in addition to the standard deduction) under the personal income tax.

Belgium

Graduated old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of covered earnings) and employers (fixed percent of covered payroll) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Canada

A combination pension system became effective during 1966 with the Canada Pension Plan, which provides graduated old-age pensions under social insurance in addition to the flat old-age pensions so far provided under a universal pension system. Graduated pensions are financed through contributions payable by employees and employers (fixed percent of covered earnings). There is no government subsidy. Flat pensions are financed through earmarked income taxes payable by all residents and corporations, an earmarked excise tax (fixed percent of manufacturers' sales), and a government subsidy.

Recipients of flat and graduated old-age pensions must include the full amount of the pension in taxable income under the personal income tax.

Employee contributions under the old-age insurance program are deductible from taxable income under the personal income tax, but the earmarked income tax paid by all residents to help finance the universal old-age pension program is not deductible from taxable income under the personal income tax.

Denmark

There are two main pension systems in Denmark. The basic system provides flat old-age assistance and universal pensions; the supplementary system provides

graduated old-age insurance pensions to employees in industry. Basic pensions (consisting of a minimum universal pension plus an assistance pension subject to a means test) are financed through a contribution payable by all residents (fixed percent of net income) and through a government subsidy. There is no employer contribution. Supplementary pensions are financed through contributions payable by employees and employers, with no government subsidy.

Old-age pensions must in principle be included in taxable income under the personal income tax. However, there is a special allowance designed to exempt from the national personal income tax all persons whose only income consists of basic old-age pensions. Moreover, single persons eligible for old-age pensions are treated for tax purposes as if they were married persons, thus putting them into a preferential income tax category.

All direct taxes paid, including social security contributions for the basic pension system, are deductible from taxable income under the personal income tax. Employee contributions for supplementary pensions are also deductible from taxable income under the personal income tax.

Finland

There are two main pension systems in Finland. Flat old-age pensions are provided through a universal pension system. They are financed through contributions payable by all residents aged 16–62 (fixed percent of income subject to the communal tax) and employers (fixed percent of payroll). There is no government subsidy. Graduated old-age pensions are provided through social insurance covering all employees in industry. They are financed through an employer contribution, with no employee contribution or government subsidy.

Recipients of old-age pensions must include, in taxable income under the personal income tax, the full amount of the pension minus certain allowances that vary with the pension amount.

Under the personal income tax, contributions by insured persons are deductible from the taxable income for the year following the year in which they were paid.

France

Graduated old-age pensions are provided through social insurance. The pensions are financed through contributions payable by employees (fixed percent of covered earnings) and employers (fixed percent of covered payroll). There is no government contribution.

Old-age pensions must in principle be included in taxable income under the personal income tax. The tax administration has, however, by administrative action exempted from tax those individuals whose pensions do not exceed a certain amount and whose total resources do not exceed a given figure.

Employee contributions are deductible from taxable income under the personal income tax.

Germany

Graduated old-age pensions are provided through social insurance. They are financed through equal contributions by employees and employers (fixed percent of covered earnings). There is no government subsidy.

Recipients of old-age pensions must include a specified percent of the pension amount in taxable income under the personal income tax. The percent varies with the age of the pensioner at the time he first collects his pension, in accordance with a table contained in the income tax law. If, for example, a person first collects his pension at age 65, 20 percent of the pension amount must be included in taxable income. The figure is 25 percent at age 60 and 15 percent at age 70.

Employee contributions are deductible from taxable income as a special allowance (in addition to the standard deduction) under the personal income tax.

Greece

Graduated old-age pensions are provided through social insurance. The pensions are financed through contributions payable by employees (fixed percent of covered earnings) and employers (fixed percent of covered payroll) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Ireland

Flat old-age pensions are provided through social insurance. They are financed through flat-rate contributions payable by employees and employers and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Israel

Flat old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of covered earnings) and employers (fixed percent of covered payroll) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are not deductible from taxable income under the personal income tax.

Italy

Graduated old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of earnings) and employers (fixed percent of payroll) and through a government subsidy.

Old-age pensions paid by the major social insurance institution are (by regulation) exempt from taxation under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Japan

There are two main pension systems in Japan. The Welfare Pension Insurance program, covering employees in industry and commerce, provides old-age pensions through social insurance. They are financed through

equal contributions payable by employees and employers (fixed percent of covered earnings) and through a government subsidy. The National Pension program, covering all other residents, provides pensions varying only with years of contribution. They are financed through contributions (varying only with age) payable by insured persons and through a government subsidy; there is no employer contribution.

Recipients of old-age pensions under either program must include the full amount of the pension in taxable income under the personal income tax. The contribution by insured persons is deductible from taxable income under the personal income tax.

Luxembourg

Graduated old-age pensions are provided through social insurance. They are financed through equal contributions payable by employees and employers (fixed percent of covered earnings) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Netherlands

Flat old-age pensions are provided through social insurance. They are financed through a contribution payable by all residents aged 15–64 (fixed percent of net income), a contribution payable by employers (fixed percent of covered payroll), and a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. The social security contribution payable by all residents is deductible from taxable income under the personal income tax.

New Zealand

Flat old-age pensions are provided through a universal pension system. They are financed through an earmarked "social security income tax" payable by all individuals and corporations (fixed percent of taxable income) and through a government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the ordinary personal income tax but not under the social security income tax. The deduction of the social security income tax is expressly prohibited in the computation of taxable income under the ordinary personal income tax.

Norway

Flat old-age pensions now provided by a universal pension system will be absorbed into graduated pensions effective January 1967. Pensions under the new system will be financed through contributions payable by employees (fixed percent of earnings) and employers (fixed percent of payroll) and through national and local government subsidies.

Recipients of old-age pensions in both the old and the new system must include the full amount of the pension in taxable income under the personal income tax.

The contribution by insured persons is deductible from taxable income under the personal income tax.

Portugal

Graduated old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of covered earnings) and employers (fixed percent of covered payroll). There is no government subsidy.

Recipients of old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

Spain

Graduated old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of covered earnings and employers (fixed percent of covered payroll) and through a government subsidy.

The basic pension legislation exempts old-age pensions from any tax.

Employee contributions are deductible from taxable income under the personal income tax.

Sweden

There are two main pension systems in Sweden. Flat old-age pensions are provided under a universal pension system. They are financed through contributions payable by all residents aged 18–65 (fixed percent of covered income) and through a government subsidy. There is no employer contribution. Graduated old-age pensions are provided through social insurance, covering all employees in industry. They are financed through an employer contribution (fixed percent of covered payroll). There is no employee contribution or government subsidy.

Recipients of old-age pensions are required to include the full amount of the pension in taxable income under the personal income tax. The contribution by insured persons is deductible from taxable income under the personal income tax.

Switzerland

Graduated old-age pensions are provided through social insurance. They are financed through contributions payable by employees (fixed percent of earnings) and employers (fixed percent of payroll) and through a government subsidy.

Recipients of old-age pensions must include 80 percent of the pension amount in taxable income under the federal personal income tax. Most cantons consider old-age pensions as taxable income but generally do not require the inclusion of the full pension amount in taxable income. (The specific tax treatment of old-age pensions varies considerably among cantons.)

Employee contributions are deductible from taxable income under federal and cantonal personal income taxes.

United Kingdom

Both flat and graduated old-age pensions are provided through social insurance. The former are financed through equal flat contributions payable by employees and employers and through a government subsidy. The latter are financed through equal contributions payable by employees and employers (fixed percent of covered earnings) and through a government subsidy.

Recipients of both flat and graduated old-age pensions must include the full amount of the pension in taxable income under the personal income tax. Employee contributions are deductible from taxable income under the personal income tax.

United States

Graduated old-age pensions are provided through social insurance. They are financed through equal contributions payable by employees and employers (fixed percent of covered earnings). There is no government subsidy.

Old-age pensions are not included in taxable income under the personal income tax. Employee contributions are not deductible from taxable income under the personal income tax.

POLICY CONSIDERATIONS

The brief descriptions of the tax treatment of old-age pensions contained in the summaries for individual countries provide some indication of the considerable range within which this treatment may vary. Of the many policy considerations that may determine legislative or administrative action resulting in a particular form of tax treatment, two have been selected for analysis here. The first area of consideration deals with the income-tax treatment of older persons in general, while the second views the tax treatment of old-age pensions in relation to the several sources of revenue that finance the pension system

Income-Tax Treatment of Older Persons

Some observations may be made concerning the relationship of the income-tax treatment of old-age pensions (as an income category) to the income-tax treatment of older persons (as income recipients). Many countries provide a variety of income-tax concessions for persons who are above a specified age (generally age 65 but in some instances at a lower age).

Under a progressive income tax, the income value of most special tax concessions (whether given to older persons or to any other grouping of taxpayers) varies directly with the marginal tax bracket of the person benefiting from the concession. For this purpose it does not matter whether a concession takes the form of exempting a person or exempting an income category—either type of concession tends to favor persons in the upper income brackets and thus cut down on the progressivity of the income tax.

For instance, an additional per capita exemption for persons aged 65 or over (by which a flat amount of income is exempted regardless of source) does not give any financial relief to those older persons whose total income falls below the amount of the ordinary per capita exemption given to all taxpayers regardless of age. Similarly, where an old-age pension is the only source of income, its tax exemption gives financial relief only to the extent that the amount of the pension exceeds the amount of per capita exemptions; thereafter the income value of the exemption of the old-age pension varies directly with the marginal tax bracket of the pension recipient.[2]

In some countries, old-age pension recipients enjoy both an additional per capita exemption and a total or partial exemption of their old-age pension. Additional tax relief may be available in some instances through favorable tax treatment of private pensions where these are received in addition to old-age pensions under the social security system.

Where special tax relief is granted to persons because of age, as most of the countries do in varying degrees, the effect of the tax relief provisions is to favor at least some aged persons over other persons in the population whose need may be as great or greater than the need automatically attributed to all older persons.

Where old-age pensions must be included in taxable income under the personal income tax, the amount of the pension and of any nonpension income determines whether or not a pensioner must pay a tax and at what rate. The amount of any income tax paid (on old-age pensions or other income) in turn depends on the range and structure of income-tax rates, which vary considerably from country to country.

Some countries apply a retirement test to determine whether a pension should be reduced or suspended if total earnings from work by a pensioner exceed certain amounts during a given

[2] See Richard Musgrave, *The Theory of Public Finance: A Study in Public Economy*, New York, 1959, page 172. The author points out that exemptions serve not only to permit differentiation according to family size (in lieu of applying different rates to taxpaying units having equal incomes but different family size) but also as a device of progression, where they constitute in fact a first bracket with a marginal rate of zero.

period. Where his pension is reduced or suspended as the result of the application of a retirement test, the specific effect on the net income of a pensioner would also be influenced by the tax treatment of his pension under the personal income tax.

In relating the income-tax treatment of old-age pensions to that of older persons in general, one may reach the conclusion either (1) that old-age pensions should be tax-exempt to provide desirable financial relief to older persons or (2) that old-age pensions should be included in taxable income since their exemption does not effectively provide financial relief to those older persons most in need of it.

Income-Tax Treatment and Sources of Revenue of the Pension System

Old-age pensions under most programs covered by this study are financed through several sources of revenue—contributions payable by employees and employers; subsidies by national, provincial, and municipal governments that are financed from general revenues or from earmarked income or sales taxes; and investment earnings of reserves. The nature and origin of each of these sources of revenue, its proportion of total revenue, and its earlier tax treatment are relevant factors presumably considered in decisions on the treatment of old-age pensions under the personal income tax.

Employee contribution.—Most old-age pension programs considered in this study adhere to some type of social insurance principle under which the risk covered (old age) is pooled for the entire insured population. As a result of social insurance, the ratio between the total amount of employee contributions paid by an insured person for coverage of this particular risk and the total amount of old-age pensions received by him may vary considerably, depending not only on sources of financing other than the employee contribution but also on (1) the relationship between covered earnings and the amount of old-age pensions computed on the basis of these earnings, (2) the maturity of the old-age pension program (that is, how many years insured persons have paid an employee contribution before first collecting their old-age pension), (3) the number of years for which the pension is received, and (4) any supplements for dependent wives and children that the old-age pension system may provide. Inevitably, this raises the question whether, for an analysis of the tax treatment of old-age pensions, the total amount of employee contributions actually paid in the past by an insured person should be considered, or whether some kind of average employee contribution for the entire insured population should be imputed to him instead.

A worker's personal income is reduced by his payment of the employee contribution, with a consequent reduction in his personal consumption expenditure or his personal saving. To the extent that they are financed by employee contributions, old-age pensions may be considered as being in the nature of deferred wages of the workers covered by the pension system. Where pensions are financed only by employee contributions and investment earnings of pension reserves, the pensions may also be viewed as being in the nature of deferred income (deferred wages plus deferred interest).

An ideal solution would require that both the social insurance principle and the concept of deferred income be taken into account when the employee contribution is considered in connection with the tax treatment of old-age pensions. In addition, some weight should also be given to the income-tax treatment accorded to the employee contribution. Where this contribution has been deductible from taxable income, the income tax has already incorporated the concept of deferred wage. On the other hand, where the employee contribution has not been allowed as a deduction from taxable income, the deferred wage is fully taxed as income even though the worker never attains any control over this portion of his income. It would therefore seem appropriate to provide more lenient tax treatment when the employee contribution has not previously been allowed as a deduction than when it could be deducted from taxable income.

Employer contribution.—Both the social insurance principle and the concept of deferred income also merit attention when the employer contribution is considered in relation to the tax treatment of old-age pensions. The employer contribution is made to the old-age pension program as a whole, rather than on behalf of a specific worker, even though, under most of the programs con-

sidered here, it takes the form of an employment-related contribution representing a fixed percent of covered payroll. It is generally deductible from gross income, as an ordinary and necessary business expense, under the corporate income tax. Usually it is deductible from gross income in this form rather than as a specified deduction.

Where employer contributions are made in the form of a fixed percent of the covered earnings of the workers, they may be considered as a form of supplemental employee income (fringe benefit).[3] None of the countries examined, however, require a person to include in his taxable income under the personal income tax the amount of any employer contribution made under old-age pension programs, even though this amount is deductible by the employer under the corporate income tax. On the other hand, employer contributions to social security programs are—in the aggregate—considered under most systems of national income accounting as a part of personal income.

The employer contribution may also be considered as being in the nature of deferred personal income (eventually received by workers in the form of old-age pensions). In this respect it differs from the employee contribution, particularly where the latter has not been allowed as a deduction against taxable income, because the employer contribution eventually enters into taxable income only in those countries that require the recipients of old-age pensions to include all or part of the pension amount in taxable income under the personal income tax. On the other hand, in those countries where old-age pensions are exempt from taxation under the personal income tax, the employer contribution is never included in taxable income: it may be deducted by employers under the corporate income tax, and it is not taxable to workers (either originally or as deferred income) under the personal income tax.

Government subsidies.—For the consideration of the treatment of old-age pensions under the personal income tax, the social insurance principle and the concept of deferred income do not apply in the same way to subsidies paid by any government (national, provincial or municipal) toward the financing of pensions as they do to employee and employer contributions. These subsidies may instead be viewed as a transfer of funds to recipients of pensions from general taxpayers or from the payers of earmarked taxes. Any share of a pension that is financed by government subsidies remains free from income taxation except in those countries where recipients of old-age pensions must include a part or the full amount of their pension in taxable income under the personal income tax.

[3] See Hugh Holleman Macaulay, Jr., *Fringe Benefits and Their Federal Tax Treatment*, New York, 1959 (particularly pages 131–8).

CONCLUSION

The foregoing analysis of the tax treatment of social security has been based on the current status of old-age pension laws and income tax laws and regulations in 22 foreign countries and the United States. No attempt has been made here to view the situation in any one country in terms of its historical development. Nevertheless, since changes in social security tax treatment in any country should be made only with full consideration being given to long-run factors, it seems appropriate to include some general observations on this point.

Income and demographic developments since World War II have resulted, in most of the countries here examined, in a significant rise in the proportion of the population subject to the personal income tax and in the proportion of the population receiving old-age pensions. Moreover, it is likely that in the next two decades both income taxpayers and pension recipients will continue to increase as a proportion of the total population in most of these countries. The income-tax treatment of old-age pensions has hence become a more important consideration in both tax policy and social welfare policy than heretofore, and it may be expected, therefore, that any future major tax reform in any of the countries included in this study will be concerned with the tax treatment of old-age pensions, indeed with the overall tax treatment of social security.

Such concern would be natural also in view of the interaction of structural changes in both old-age pension programs and income taxation that have taken place in many countries during the postwar period. For instance, in countries where

pensions are not included in taxable income under the personal income tax, a rise in the amount of his pension has also increased the value of its tax exemption to the individual pensioner, particularly where there has been no increase in the amount of per capita exemptions applicable to the general population under the personal income tax.

As there is an increase in the percentage of the population that receives or will ultimately receive old-age pensions, the importance of the tax treatment of pensions also rises. Where old-age pensions (other than those financed exclusively from employee contributions) remain completely exempt from income taxation, a social policy decision to redistribute incomes between generations rather than between income classes may be implied. The weight of this implied decision may be greatest where the method of financing an old-age pension system has undergone substantial structural changes, as has happened in many countries during the postwar period. Particularly, where the share of the total pension cost covered by employer contributions or by government subsidies continues to rise substantially, the amount escaping annually from taxation as a result of an exemption of old-age pensions from the income tax may reach a level that would eventually reduce its effectiveness.

Notes and Brief Reports

State Income-Tax Laws on OASDHI Benefits and Contributions*

Most States that levy personal income taxes follow the Federal tax rule of exempting from the tax all benefits under the old-age, survivors, disability, and health insurance (OASDHI) program. In addition, a majority of these States follow the Federal rule of not permitting the amount of the employee's social security contributions to be deducted from income subject to tax.

Among the 37 States[1] with personal income-tax laws, only Mississippi does not exclude OASDHI benefits from the State income tax.

Thirteen States have no personal income-tax laws; these States are Connecticut, Florida, Illinois, Maine, Michigan, Nevada, Ohio, Pennsylvania, Rhode Island, South Dakota, Texas, Washington, and Wyoming.

Some States, with or without personal income-tax laws, have empowered one or more of their cities to levy an income tax, typically ranging from ½ of 1 percent to 1 percent of gross earnings. The several city income-tax laws on which information was available have followed the Federal tax rule, commonly by adopting the definition of "taxable income" as computed under the Federal Internal Revenue Code.

The States show greater variation in their tax treatment of social security contributions than in their treatment of benefits. Thirty-one States, including Mississippi, require the social security contributions to be included in the amount of income subject to tax. Six States permit these contributions to be deducted from the amount of income that is subject to tax. Iowa distinguishes between the contributions of the self-employed and those made by employed persons: the contributions of employees, but not those of the self-employed, are deductible.

In the 31 States that do not permit deduction of contributions from income subject to State income tax, employees and self-employed persons will contribute to the OASDHI program in 1966 an estimated $6.6 billion from earnings. Although it is subject to State income tax, not all of the $6.6 billion will actually be taxed. In some instances, an individual's income (including all or part of his contribution to social security) after exemptions, deductions, losses, etc., may fall below the level at which income is taxable by the State. In Mississippi, for example, with personal exemptions at $5,000 for a single person and $7,000 for a married person, workers with incomes below these amounts will not have to pay State income tax at all, and, of course, the amount of OASDHI contributions represented in such lower incomes also will not be taxed by the State.

* Prepared by Warren J. Baker, Program Studies Branch, Division of Program and Long-Range Studies. See also the *Bulletin* for September 1959, page 20.

[1] New Hampshire and Tennessee, which levy a personal income or excise tax only on interest and dividend income, are excluded from this analysis.