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TAXATION OF LIFE-INSURANCE COMPANIES

MARCH 10, 1958.—Ordered to be printed

Mr. BYRD, from the Committee on Finance, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany H. R. 10021]

The Committee on Finance, to whom was referred the bill (H. R. 10021) to provide that the 1955 formula for taxing income of life-insurance companies shall also apply to taxable years beginning in 1957, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

The bill would amend the Internal Revenue Code of 1954 by applying the tax imposed by section 802 on the income of life-insurance companies to taxable years beginning in 1957. Under present law this section applies only for taxable years beginning in 1955 or 1956.

REASON FOR THE BILL

Life-insurance companies have been taxed under various stopgap formulas since 1950. Each of these formulas has specified a tax computation for a particular year in lieu of the basic formula contained in the code, the method of taxation for life-insurance companies which was adopted in 1942. Both the 1942 formula and the various stopgap formulas which have applied to date designate a part of investment income as taxable.

Beginning in 1955, life-insurance companies were taxed under a formula provided by H. R. 7201 (Public Law 429 of the 84th Cong.), which was originally presented as a permanent method of taxing life-insurance companies in 1955. At that time the Secretary of the Treasury endorsed the formula as a 1-year stopgap for 1955 with the understanding that the Department of the Treasury would shortly

submit a recommendation for permanent legislation on the basis of total income rather than on an investment-income formula.

Following the Treasury's recommendation, the formula of H. R. 7201 was applied for 1955. The basic 1942 formula was not repealed and thus would apply to any year for which new legislation is not enacted. Since the Treasury had not developed an alternative plan, the formula of H. R. 7201 was again applied to 1956 (Public Law 785 of the 84th Cong., 2d sess.).

Since the Treasury has not as yet fully developed its proposals for a permanent method of taxation of life-insurance companies, these companies are again faced with uncertainty as to the method under which they will be taxed in respect to their operations for 1957, and unless new legislation is adopted the 1942 formula will apply.

Although a reapplication of the 1942 formula would increase the overall tax liabilities of life-insurance companies by an estimated $124 million or about 43 percent above the stopgap method, it would also involve substantial shifts in burden among companies, in relation to their total tax load and their taxable capacity.

Several factors account for this varying impact. One is the special treatment for smaller companies provided under the stopgap law but not under the 1942 formula. The 1942 formula provides a 77.66-percent reserve and other policy liability deduction for all companies in 1957, leaving 22.34 percent of their net investment income subject to tax at regular corporate rates. The stopgap method generally allows an 85-percent deduction, leaving 15 percent of the income subject to tax. However, the deduction is 87½ percent on the first $1 million, leaving 12½ percent of this amount subject to tax. Consequently, for very large companies the shift from an 85-percent to a 77.66-percent deduction would mean about a 49-percent increase in the tax base and tax liability. For companies with incomes under $1 million, the shift would be from 87½ percent down to a 77.66-percent allowance, involving about a 79-percent increase in their tax base. Because of the interplay of the insurance company deduction and the surtax exemption for corporations generally, the percentage increase in tax would be still greater at some income levels, ranging as high as 136 percent for a company with $200,000 net investment income.

The Treasury Department in public statement before the Committee on Finance on Wednesday, March 5, 1958, promised to submit its recommendations for a permanent tax formula for life-insurance companies to the House Committee on Ways and Means on Monday, April 7, 1958.

The Secretary of the Treasury in identical letters of January 10, 1958, to the chairmen of the Senate Committee on Finance and House Committee on Ways and Means, said:

> Pursuant to various conversations which we in the Treasury have had with you and other members of your committee, I am writing with reference to the income-tax law which will apply to the 1957 earnings of life-insurance companies, concerning which the members of your committee and the Treasury have been and are receiving a large number of inquiries.
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> As you know, in the absence of new legislation, life-insurance companies will be taxed for the year 1957 in accordance with the 1942 formula which has not been applied since 1948. I believe it to be generally agreed that the application of the

1942 formula would, after a lapse of 8 years, produce some inequitable results.

For the taxable years 1949 through 1956 a succession of interim laws were adopted, of which the most recent was the law effective for the taxable years 1955 and 1956.

The Treasury Department believes that it is most desirable that a permanent method of taxation of life-insurance companies be worked out, and we hope to propose in the very near future an approach which we believe will be reasonable and equitable for the foreseeable future.

I am sure that the House Ways and Means and the Senate Finance Committees will want to consider any such proposals in the light of testimony that will be submitted and other considerations which the members of your committee may want to suggest or evaluate.

Under these circumstances, and because of the complexity of the subject, it is not probable that final legislation, along whatever lines the Congress determines is appropriate for permanent legislation, could be adopted before March 15 when the returns for the 1957 taxable year are due.

An important fact is we are dealing with institutions with responsibility for the insurance policies of millions of American people and final decisions by the life-insurance companies as to policy dividends and surpluses for the year 1957 will depend to some extent on the final determination of their tax liability. In view of this, and in order to assure full consideration of the best permanent method of taxation of insurance-company income, it would seem reasonable to extend the law effective for the taxable years 1955 and 1956 for another year and make it applicable for 1957 income. It would be my hope that we could then proceed to work out a permanent method of taxation in this area which would be fair and equitable.

Accordingly, the Treasury would go along with an extension of the 1955 legislation so that it might be applied to 1957 income of life-insurance companies.

In reiterating the position of the Treasury Department in favoring the extension of the 1955 stopgap formula as proposed in H. R. 10021, the following letter was subsequently submitted to the chairman:

TREASURY DEPARTMENT,
Washington, March 6, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: I want to make the record clear that no statement which I made yesterday before your committee was intended to indicate any dissent from the statement which the chairman of the House Committee on Ways and Means made before the House on H. R. 10021.

With reference to the tax to be imposed on life-insurance companies, all of us are most interested in permanent legislation which will obviate any need for annual review. Satisfactory permanent legislation, in our opinion, would not be achieved either by the 1942 law or by an indefinite extension of the 1955 stopgap formula.

Under the circumstances, the Treasury advised the Ways and Means Committee that it was agreeable to the application of the stopgap legislation for 1 year, and thus joined with the Ways and Means Committee in such an extension. This is in accord with the statement of the chairman of the House Ways and Means Committee on January 30 in the House.

Sincerely yours,

DAN THROOP SMITH,
Deputy to the Secretary.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

Chapter I—Normal Taxes and Surtaxes

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SUBCHAPTER L—INSURANCE COMPANIES

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Part I—Life Insurance Companies

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SUBPART A—1955 FORMULA

Sec. 801. Definition of life insurance company.
Sec. 802. Tax imposed [for 1955 and 1956].

SEC. 802. TAX IMPOSED [FOR 1955 AND 1956].

(a) TAX IMPOSED.—A tax is hereby imposed for each taxable year [beginning in 1955 or in 1956] *beginning after December 31, 1954, and before January 1, 1958*, on the income of every life insurance company. Except as provided in subsection (c), such tax shall consist of a normal tax (computed under section 11 (b)) and a surtax (computed under section 11 (c)) on the sum of—

(1) the life insurance taxable income (as defined in subsection (b)), plus

(2) the non-life insurance taxable income (as defined in subsection (f)).

* * * * * * *

(c) ALTERNATIVE TAX IN THE CASE OF COMPANIES HAVING NON-LIFE INSURANCE RESERVES.—

(1) IN GENERAL.—In the case of a life insurance company which has non-life insurance reserves, the tax imposed by subsection (a) of this section for any taxable year [beginning in 1955 or in 1956] *beginning after December 31, 1954, and before January 1, 1958*, shall be the tax computed under such subsection (or under section 1201 (a) if applicable) or the tax computed under paragraph (2) of this subsection, whichever is the greater.

(2) ALTERNATIVE 1-PERCENT TAX ON NON-LIFE INSURANCE BUSINESS.—The tax referred to in paragraph (1) is a tax equal to the sum of the following:

(A) A partial tax consisting of a normal tax (computed under section 11 (b)) and a surtax (computed under section 11 (c)) on the life insurance taxable income.

(B) A partial tax consisting of—

(i) 1 percent of the amount which bears the same ratio to the gross investment income (reduced by the deduction for wholly-exempt interest allowed by section 803 (c) (1)) as the non-life insurance reserves bear to the qualified reserves (determined under section 804 (c)), plus

(ii) 1 percent of the excess of the amount by which the net premiums on contracts meeting the requirements of section 804 (d) (2) (A) exceed the dividends to policyholders on such contracts. For purposes of this clause, net premiums, and dividends to policyholders, shall be computed in the manner provided in section 823.

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SEC. 811. TAX IMPOSED.

(a) TAX IMPOSED.—A tax is hereby imposed, on the life insurance company taxable income of every life insurance company, for each taxable year beginning after December 31, [1956] *1957*. Such tax shall consist of—

(1) a normal tax on such income computed under section 11 (b), and

(2) a surtax on such income computed under section 11 (c).

MINORITY VIEWS

The evidence presented to the Senate Finance Committee does not, in our opinion, justify passage of H. R. 10021.

The provisions of the Internal Revenue Code with respect to life-insurance companies were enacted in 1942. It is under terms of this law that the 1957 tax liabilities of insurance concerns have accrued and on which payment is due March 15, 1958. Mr. Dan Throop Smith, deputy to the Secretary of the Treasury, testified before the committee that the United States Treasury Department would "go along" with enactment of H. R. 10021. When asked, however, if he knew of "undue hardship that would be imposed or that is imposed by the present tax law," he answered, "Hardship? No; I am not aware of any."

Then, when asked if it would be unreasonable to require insurance companies "to pay their tax liability as levied under the present law," Mr. Smith replied, "Not to my knowledge, that would not be unreasonable either."

Moreover, witnesses from the insurance industry itself did not claim that the 1942 law generally constituted an undue hardship. Indeed, one of the witnesses, Mr. Charles A. Taylor, president of the Life Insurance Company of Virginia, said, "No, sir, I cannot come here begging for relief * * *"

In fairness to the insurance companies, it should be said that the 1942 law has upon several occasions been superseded by temporary legislation, and that many insurance companies presumed, or were led to believe, that it would again be superseded with respect to 1957 income. Congress has not done so, however, and 1957 taxes are now owed.

So, passage of H. R. 10021 now would constitute retroactive tax reduction for insurance companies in an amount estimated to be $124 million.

The record of the hearings before the Senate Finance Committee fails to identify the principal beneficiaries of the enactment of H. R. 10021. Since the bill was reported by the committee, we have conducted a preliminary examination of the financial statements of the 10 largest life-insurance companies. From this examination, it would appear that of the $124 million in tax forgiveness that would be shared by more than 1,000 life-insurance companies, should H. R. 10021 be enacted, the 10 largest companies would receive approximately $75 million. The record of committee hearings contains no evidence whatsoever that existing law levies an unfair or unreasonable tax burden on these principal beneficiaries of the bill.

Retroactive tax reduction, or tax forgiveness, is a highly questionable procedure and should be resorted to only in cases of extreme hardship and clear justification. The record contains no evidence of such hardship or justification in this case.

CLINTON P. ANDERSON.
ALBERT GORE.
JOHN J. WILLIAMS.

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