

# REVENUE ACT OF 1932

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## HEARINGS

BEFORE

THE COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-SECOND CONGRESS

FIRST SESSION

ON

**H. R. 10236**

AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION  
AND FOR OTHER PURPOSES

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MAY 20, 1932

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**SUPPLEMENT No. 3**

**INCOME TAX EXEMPTION OF  
MUTUAL INSURANCE COMPANIES**

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Printed for the use of the Committee on Finance



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### **PREFACE TO SUPPLEMENT NO. 3**

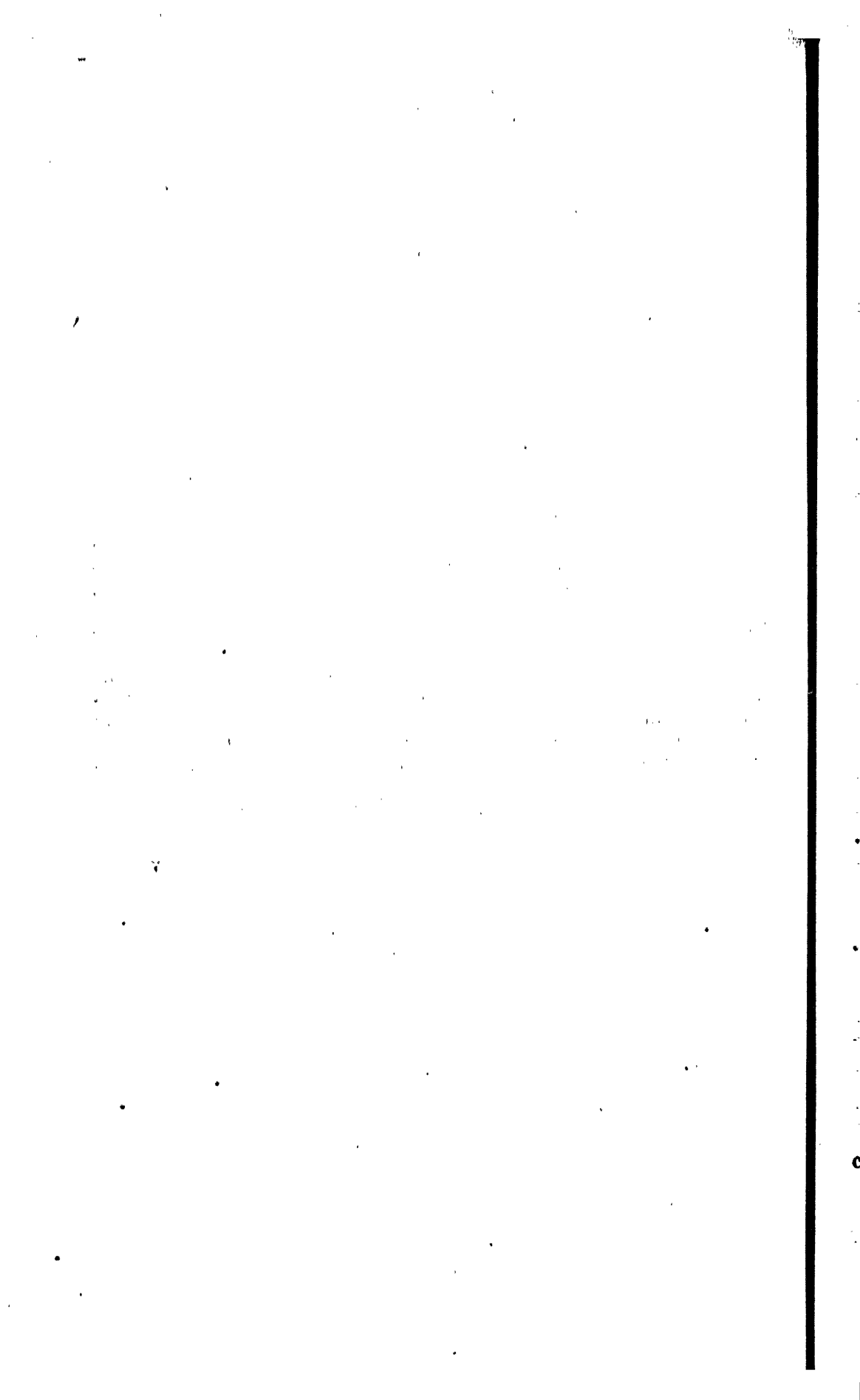
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After the conclusion of the hearings on the revenue act of 1932, H. R. 10236, on April 21, 1932, the Finance Committee met in executive session from April 25, 1932, until May 9, 1932, for the purpose of revising the bill as passed by the House of Representatives. The bill, as finally adopted and reported to the Senate, restricted the exemption from taxation of mutual insurance companies to those types commonly known as "farmers," "county," "town," or "local" mutuals. When this section was reached for consideration by the Senate several Senators requested that the Finance Committee permit representatives of the mutual insurance companies to testify in regard to this restriction. The Finance Committee accordingly granted this privilege and held a hearing on May 20, 1932, which is here printed in full.

A table of contents has been prepared and is appended hereto.

ISAAC M. STEWART, *Clerk.*

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## REVENUE ACT OF 1932

### TO EXEMPT MUTUAL INSURANCE COMPANIES FROM TAXATION UNDER THE 1932 REVENUE BILL

The CHAIRMAN. The committee will come to order. The first witness is Harry F. Gross, of the National Association of Mutual Insurance Companies. I wish to say that of those who desire to be heard we have six names on the list, and I hope those following Mr. Gross will not repeat what he may say.

Senator WATSON. Mr. Chairman, are these the big mutual life-insurance companies?

The CHAIRMAN. No. These are the mutual insurance companies along other lines.

Senator WATSON. Not mutual life-insurance companies also?

The CHAIRMAN. No; fire, automobile and casualty insurance companies, I believe.

Senator LA FOLLETTE. But no mutual life-insurance companies.

### STATEMENT OF HARRY F. GROSS, DES MOINES, IOWA, REPRESENTING THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. Gross. Mr. Chairman and gentlemen of the Finance Committee, we are not unmindful of the serious tasks and duties you have before you during this Congress, and we want to express our keen appreciation for the privilege that you have accorded the mutual insurance companies and association of the United States by way of this hearing.

There are something like 2,000 or more mutual insurance companies that are vitally interested in this problem, and I assume that you understand and that we have under consideration at this time the proposed amendment as recommended by the Finance Committee or that is found in the Senate tax bill under section 103, paragraph 11:

(11) Mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) of the type commonly known as "farmers," "county," "towns," or "local" mutuals, the income of which is used or held for the purpose of paying losses or expenses.

And also section 208, the section that refers to insurance other than life and marine insurance.

I think I should state that so that we may have at the outset a clear understanding of what is under discussion.

Now, gentlemen of the committee, these mutual insurance companies which I have the privilege of representing are not organized for profit. There is no element of profit entering into any of the transactions of their business, especially the vast army of mutual

insurance companies that are in the Central and Mississippi Valley States, and I think there are a number in Pennsylvania and other States.

We are seriously interested in this problem, as you may gather from the large number present this morning. The secretaries, managers, and other officers of the mutual insurance companies are here this morning from Kansas, Iowa, Missouri, Wisconsin, Illinois, Kentucky, Indiana, Ohio, Michigan, Pennsylvania, the Virginias, New York, Massachusetts, and practically all other States east of the Mississippi River.

Mr. Cooper, secretary and manager of the National Association of Mutual Insurance Companies, of Indianapolis, will give you a brief résumé of the difficulties we have encountered and what the most serious objections are to the situation under the proposed Senate amendment.

The CHAIRMAN. The committee will be glad to hear Mr. Cooper.

**STATEMENT OF HARRY P. COOPER, INDIANAPOLIS, IND.; SECRETARY AND MANAGER OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES**

Mr. COOPER. My name is Harry P. Cooper. My business since moving to town has been mutual insurance. For nearly 26 years, a number of them, while on the farm, I have served as secretary of one of the oldest and largest Indiana Farm Mutuals.

In 1907 we farm mutuals organized the Indiana Mutual Cyclone Insurance Co. to carry the windstorm insurance for all the mutuals of the State.

In 1918 we farm mutuals organized the Indiana Union Mutual to take care of the farm business which the farm mutual under its law could not write.

In 1925 we organized the Farmers Mutual Liability Co. to carry the workmen's compensation insurance which the farm mutuals by law are required to carry and to carry the automobile and workmen's compensation for the members of the farm mutuals of the State, and in 1928 a mutual hail company to insure growing crops. Of these last I have been an official since organization. Neither of these could be organized under the county farm mutual law. The cyclone company and the hail company were organized under a special act and the others under the general mutual law. This indicates how difficult it is to draw a line which divides the farm mutual from other mutuals.

Since 1913 I have served as secretary of the National Association of Mutual Insurance Companies; 740 mutuals are paid up active members. Approximately 100 more are a bit in arrears and 1,400 of the remainder cooperate in various association activities including educational and legislative work. This includes about 75 member companies operating along lines similar to the farm mutuals and cooperating with and assisting the farm mutuals in many ways. For example, the mutuals insuring grain and grain elevators.

Eighteen years ago the farm mutuals were paying fines because of failure to report under the excise tax law. Representative Hull said the law was not intended to affect farm mutuals. Senator Shrively and Representative Morrison with Mr. Hull assured me that the fines would be stopped and they were.



Sixteen years ago Senator Taggart took our farm mutual committee to Chairman Claude Kitchen of the Ways and Means Committee. Mr. Kitchen assigned Representatives Dixon and Rainey to hear our troubles and recommended a wording in the tax law that would exempt us. We went home with a feeling of assurance that our tax troubles were over, and they were for a while.

Under that and each succeeding law, regardless of the attempts to exempt us, we later found we were caught by the interpretation. The injustice of a tax was recognized and the law broadened from time to time. Even a retroactive amendment was adopted in the Senate by a nearly unanimous vote relieving these companies from the payment, or if payment had been made, permitting refunds.

Our own county mutual had been checked and nearly \$1,200 demanded as one year's tax. Many others were caught and many paid but through the kindness and just consideration of Congress and the Treasury Department, we were able to recover. Because of our troubles the law was broadened from time to time. In fact up to and including 1926, when the present farm mutual section was adopted, practically every tax revision bill gave us more latitude.

After conference with Chairman Green and other members of the Ways and Means Committee, it was my impression that subsection 11 of 103 would not require reports or losses of our farmers' automobile, compensation, hail, cyclone, or fire insurance companies, nor of the dwelling house mutuals or for similar mutuals. It seems, however, that I was wrong in this. It has even been insisted that money held in exempt companies must be held for "accrued" losses and expenses, although the word "accrued" does not appear in the farm mutual section (11) of 103.

This was not so bad for either our farmers' automobile or compensation companies, or hail, or cyclone, or fire insurance companies, so long as when required to report we could deduct the money held for future losses and expenses as provided in 3 of section 208. But with it changed we will be hurt more than other companies because but few are required to carry a reinsurance reserve.

The CHAIRMAN. Wouldn't you prefer that we talk about section 208 of this bill? What you have given us is now past history.

Mr. COOPER. I know it is, Senator Smoot, but it shows that the law has been one thing and the interpretation of law another thing, and we have been plagued to death for 20 years.

The CHAIRMAN. But the committee wants to know what change you desire in section 208 of the revenue bill.

Mr. COOPER. We want a complete exemption, if you please.

Senator WATSON. Where would you write it?

The CHAIRMAN. I suppose he means just to take that all out of the bill.

Senator COUZENS. What section is it that you want changed?

Mr. COOPER. Section 208.

Senator COUZENS. What language?

Mr. COOPER. Section 103, paragraph 11, found at page 63 of your proposed revenue act of 1932.

The CHAIRMAN. I thought you were speaking of section 208.

Senator WATSON. What he is talking about is found on page 63, being paragraph 11, mutual hail, cyclone, casualty, or fire insurance companies or associations. Is that right, Mr. Cooper?

Mr. COOPER. Yes, sir.

The CHAIRMAN. Go ahead. Do you want the House provision?

Mr. COOPER. Yes; the House provision is satisfactory, providing the House provision prevails in paragraph 8 of section 208. But what I am trying to tell you gentlemen now are the troubles we have had and are having at the present time.

Senator LA FOLLETTE. I think it is pertinent to this discussion.

The CHAIRMAN. All right. Go ahead and tell the troubles you have had.

Mr. COOPER. If we may judge the future by the past it would seem that no farm mutual would be exempt under the proposed wording, except those that spend more money than they take in and confine their business to a township or county at most. My experience has been that treasury interpretations restrict even more than we farmers anticipate.

Many changes have occurred in the insurance needs of the farmer in the last 25 years. Then the farm mutuals were small, most farm buildings of small value. The automobile, truck and tractor were then unknown on the farm. But few farms had a gasoline engine. No farm mutual would insure it or the building in which it was housed. To-day farm buildings are large and commodious, making larger insurance risks, requiring a greater territory and more risks for safety for both fire and wind.

It is a matter of common knowledge that the windstorm insurance can not be safely conducted on a county basis. Single counties have suffered \$100,000 loss or more on farm property in a single storm. Hail is equally hazardous in a limited territory. Many believe such business should be conducted by companies covering a whole State or a group of States.

To-day we have the casualty insurance needs caused by the automobile and its use, and the compensation claims of injured workmen. These may entail misfortune more disastrous to the farmer and town home owner than the burning of his home or the blowing away of his barns. To care for such needs we have, through our State associations or otherwise, organized automobile mutuals and compensation mutuals. So these to-day are an important part of the farm mutual family.

Business methods have changed. Under pressure of mortgages many farm mutuals are keeping some ready cash on hand. The United States Department of Agriculture has taught that sound business methods require more uniform assessments and at regular intervals, rather than different rates according to each particular loss as in years gone by, when an assessment was made after each loss and just for an amount to cover that loss. To-day every farm mutual wants a bit of reserve or safety fund. It is required of their automobile and compensation companies, and in some States of the fire, wind, and hail mutuals.

Three years ago many county mutuals had a considerable safety fund that to-day are thousands of dollars behind, can borrow no more money at bank, and are hard pressed by their bank for money already loaned. Many members are dropping out, unable to pay their small assessments or premiums. With such conditions, the exemption should be broadened and made sure rather than restricted and filled with uncertainty.

To-day as never before the Federal land bank is insisting on farm mutuals having ready money for losses. Heavy fluctuations in losses from year to year offer opportunity in lighter years to accumulate and carry over funds for use in heavier years. This applies in fire as well as wind and hail although the fluctuations are more drastic in wind and hail. They ought to be encouraged now as never before to prepare for a rainy day.

Our companies were organized and are operated to prevent misfortune if possible. Then when misfortune does come, it is shared in a proportionate way by the group. Any tax imposed is a tax on misfortune, a tax for the privilege of sharing that misfortune.

Congress has appropriated hundreds of million dollars to encourage cooperation. Our companies have never asked for a single dollar except a few have sought loans of the intermediate credit banks, and were refused. Any tax on any of our companies is a discouragement to mutual cooperation and will dishearten as nothing else can do. Hundreds of our secretaries have a dread of making income-tax reports. They feel helpless when it comes to considering such a report and such a tax.

They appreciate the attitude of Congress in years past in broadening their exemption, and of the Treasury Department in approving it. They can not believe to-day you will adopt a wording other than a complete and certain exemption.

Senator COSTIGAN. What is the language that you want taken out on page 63? Have you that page before you?

Mr. COOPER. No; I do not have that.

The CHAIRMAN. He wants the House provision.

Senator COSTIGAN. It is paragraph 11 in italics, and you want the paragraph 11 just above it which has a line run through it.

Mr. COOPER. We would really like this: Amend section 103, subsection (11), page 63, lines 10 to 15, to read:

(11) Mutual insurance companies, including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies.

And then stop there.

Senator COSTIGAN. Then he does not want paragraph 11 as we have it.

Senator COUZENS. You are only speaking for the farmers' mutuals?

Mr. COOPER. Yes; that is what I am talking about. But in that connection I ask the question: What is a farmers' mutual? In many States the law for years has permitted them to insure dwellings and properties of that kind, and the farmer's needs have increased so many, many times that he must to-day have compensation insurance, automobile insurance, liability insurance, and our farm mutuals have been trying to take care of that need. So it has come to the point where it is hard to say where a farm mutual quits and the other begins.

Twenty-five years ago there were no trucks and tractors and automobiles on the farm. To-day every farmer has a truck and a tractor and an automobile, and the effort of these mutual companies is to carry that business at cost. They want to prevent loss, and because of that prevention idea they have adopted certain rules and regulations as to these matters. But when a fire occurs, each member shares his common part of the loss.

I have here the figures of one of the county mutuals of Senator Smoot's State, the only one in his State, and over a long period of years they have an average annual cost of \$1.68 per \$1,000 of insurance, against a cost in the case of competing companies of \$6 per \$1,000.

Now, as I say, the business needs have increased, the requirements have increased. Under the interpretations of the Treasury Department a good many times they have said we were not farm mutuals because we have a little money on hand. And the Federal land bank says: We don't want your policies unless you have money. And the Treasury Department says: If you have money you are not a farm mutual and we will tax you.

And so it is we feel the exemption should be so broad that any possible uncertainty would be removed. Many of the farm mutuals are scared to death about the possibility of being taxed, and many of them have not the money to come down and fight their own battles. And as I understand the situation they are taken as a unit, and each type must stand on its own bottom.

Senator GEORGE. You do not pay dividends?

Mr. COOPER. No, sir. There are so many ways in which they operate that it would require quite a long statement to make a differentiation.

The CHAIRMAN. In what way do you pay Government taxes?

Mr. COOPER. We are not paying a tax now, but as I said a minute ago, you passed a retroactive amendment some years ago that relieved us of the taxes that had been piled up. And then the Treasury Department said when we were not purely local mutuals they would tax us.

The CHAIRMAN. Do you think you would be taxed under the Senate amendment?

Mr. COOPER. I think so.

The CHAIRMAN. What companies would not be taxed under that?

Mr. COOPER. I think the only company that would be exempt under that would be the one that paid out more than it takes in, that confines its business to not more than a county.

The CHAIRMAN. You would not pay any tax if you had no profits, certainly?

Mr. COOPER. But we are not required to maintain free insurance reserves or anything of the kind. For instance, Mr. Gross here collects over a 3-year period, or he makes his assessment, but he doesn't pay it nearly all out, and probably would have \$600,000 left over, on which he would be taxed. Then the next year that \$600,000 is caught again. Our own company collected \$135,000 more last year than we paid out.

The CHAIRMAN. What did you do with it?

Mr. COOPER. Eight thousand five hundred checks were issued before the 1st of April in payment of windstorm losses that occurred.

The CHAIRMAN. Well, suppose you have \$10,000 by way of profits this year.

Mr. COOPER. It is not a profit.

The CHAIRMAN. What do you do with that money?

Senator WATSON. Yes; if you take in more than you pay out, explain that.

Mr. COOPER. It may all be eaten up before the first week of January is gone.

The CHAIRMAN. Say you have \$10,000 as of last year more than was paid out?

Mr. COOPER. All right.

The CHAIRMAN. Is that \$10,000 carried on to the next year and in the way you operate that amount left is imposed upon each farmer for his insurance?

Mr. COOPER. That is available the next year for payment of losses.

The CHAIRMAN. Do you use any of that by way of increase of salaries?

Mr. COOPER. Oh, no.

Senator WATSON. Well, at least you have a certain amount of cash in bank, haven't you?

Mr. COOPER. Very few of these fellows get what you would call a salary.

Senator WATSON. You have so much cash in bank to-morrow, we will say, and it may be more or less, but you are taking care of losses with it.

Mr. COOPER. Yes, sir. And I want to say inasmuch as the matter of salaries has been brought up that many of these secretaries get as low as \$75 a year.

Senator WATSON. You do not distribute dividends?

Mr. COOPER. No, sir.

Senator WATSON. You do not pay on any interest on money?

Mr. COOPER. The excess that you may collect this year—well, we try to strike an average I will say first. The United States Department of Agriculture suggested that we find an average, and that on light years we collect that average so that we will say this year it would not be heavy. We do not want to have to bounce way up one year, but I might say in regard to that that hundreds of them are jumping up.

Senator GEORGE. Sometimes the losses are light and sometimes they are heavy?

Mr. COOPER. Yes, sir.

Senator GEORGE. And you can not absolutely foreknow what is going to happen?

Mr. COOPER. No, sir.

Senator GEORGE. How are your officers elected?

Mr. COOPER. By the policyholders.

Senator GEORGE. And the salaries of officers are fixed by the directors?

Mr. COOPER. They are fixed by the policyholders.

The CHAIRMAN. What is your salary?

Mr. COOPER. My salary as assistant secretary of the Indiana Mutual Fire Insurance Co. is \$1,200 a year. [Laughter.]

The CHAIRMAN. Are the presidents of the mutual insurance companies paid salaries?

Mr. COOPER. Some are and some are not. It depends upon the size of the company.

Senator WATSON. Well, Mr. Cooper, what do you do with all that salary? [Laughter.]

Senator GEORGE. That is not much of a problem to you, is it?

Mr. COOPER. Hardly. The biggest salary that I know of in the case of any of these companies is \$12,000 a year, and I will say that that company saves to the farmers of that State more than \$1,000,000

a year. And they have a good many millions of dollars of insurance in force.

Senator COUZENS. I should like to draw the committee's attention to a communication addressed to Representative Hawley, chairman of the Joint Committee on Internal Revenue Taxation, dated December 27, 1929, wherein this matter is gone into at considerable length, and from this report it is quite clear it was not the intention to tax these companies such as the witness is talking about. It was rather the large companies that have carried large surpluses. I wondered if this witness has any objection to the large mutual companies being taxed.

Mr. COOPER. Well, I will say that if there are any that really ought to be taxed, all right. But I do not think you ought to penalize 2,200 organizations that are saving the people millions of dollars in order to get maybe a dozen or two dozen that you think ought to be caught.

The CHAIRMAN. Can you suggest any language?

Mr. COOPER. No; I am sorry I can not. I feel this way, folks, about the matter——

The CHAIRMAN (interposing). I want you to know that it has always been the intention of this committee, and no doubt is to-day, not to tax farmers insurance companies that are just mutual and local.

Mr. COOPER. I know that, Senator Smoot, and we appreciate it, but——

The CHAIRMAN (interposing). And we have never attempted to do it.

Mr. COOPER. I know that that is true. But, Senator Smoot, you know it is the interpretation that comes after a law is passed that has plagued us to death, the uncertainty of the thing. We may think we are free, and then the first thing we know, and as Senator Watson knows, I am down here and I say to him: Here is the interpretation on this law. What are we going to do about it?

Senator WATSON. Well, Mr. Cooper, do you think they are taxed under this?

Mr. COOPER. It does not bother me so much, but——

Senator WATSON (interposing). You are not taxed under this provision, are you?

Mr. COOPER. Well, Senator Watson——

Senator WATSON (interposing). What about that, Mr. Bartholow?

Mr. BARTHOLOW. Under prior laws we had a reconsideration of about 85 per cent of the income where they were not exempted.

Mr. COOPER. Here is Mr. Gross, and here are a lot of others, and if they do not make an assessment this year and if they had \$50 of interest income they were not exempted.

Senator WATSON. Do you say those are not taxed?

Mr. COOPER. But when this bill is enacted into law I am afraid they will say we are.

Senator WATSON. But the same experts of the Treasury Department will have to pass upon it.

Mr. COOPER. I know, and I am sorry to have to say it, but we have been up against this thing for 20 years.

Senator GEORGE. And you do not want to trust to any mistakes?

Mr. COOPER. No, sir.

Senator WATSON. But the man we have to pass upon it says you are not taxed. What more can you ask? I do not know of any stronger language than that.

Mr. COOPER. Personally, I feel like George A. Christensen, secretary of the only mutual in Senator Smoot's State. George said "Harry, I love my country. I would do nothing to hurt it. I will pay gladly any tax Congress may impose upon me. But let us do everything in our power that our members shall not be taxed for the privilege of sharing each others misfortune, nor have that misfortune increased by a Federal tax."

Gentlemen, you may tax my automobile, gasoline, luxuries, and what not.

Senator WATSON. Well, we are going to do that.

Mr. COOPER. You may raise the rate on my income to any figure your judgment may dictate. I shall pay it gladly. But, Senators, won't you encourage the disheartened farmers? Won't you make sure that his mutual insurance company may operate, whether fire, hail, wind, livestock, automobile compensation, or liability, without the fear of a tax or an income-tax report?

The CHAIRMAN. There is no difference between us as I see the situation.

Mr. COOPER. Senator, please give us a wording that will protect us.

The CHAIRMAN. Well, these men sitting here are the men who are going to decide it.

Mr. COOPER. Well, we just want to be protected.

The CHAIRMAN. These are the men who are going to decide as to whether the tax shall be imposed, and they say there is no tax. I want to say this, that all these amendments will be made public and will be printed and you can have a copy of them. If there is any tax imposed upon the companies you are interested in, simply take the report of this hearing before whoever may take the matter up.

Senator BARKLEY. Mr. Chairman, isn't it possible for us to write language so clear that no one would have to look up the proceedings of our hearing?

The CHAIRMAN. I say if such a thing should happen. What wording would you suggest by way of a committee amendment?

Mr. COOPER. I suggested that we follow the House wording, or use this wording I presented that is a clear-cut exemption.

The CHAIRMAN. Mr. Beaman, why wouldn't that cover the situation, the House provision?

Mr. BEAMAN. It exempts companies other than the ones he is talking about. It exempts all mutual insurance companies.

The CHAIRMAN. And that, of course, you do not want.

Mr. COOPER. I will say that I am more interested in the exemption of the 2,260 mutuals I am representing here.

The CHAIRMAN. Officials of the Treasury Department say you are in that class of companies which would be exempt under the wording of the Senate amendment.

Mr. COOPER. Well, they refused to give our Farmers Mutual Liability Co. an exemption.

The CHAIRMAN. Well, that of course was not under this provision.

Mr. COOPER. It was under another provision which was broader.

Senator COUZENS. I think, Mr. Chairman, we can take this report which was made to the Joint Committee on Internal Revenue Taxa-

tion, and draft language covering that matter as contained in the report. The report is very clear as to what is intended to be covered by the act as we have drafted it. It seems to me we would be rather stupid if we could not fix it so that these companies the witness is talking about would not be exempted.

The CHAIRMAN. There is no question but what this committee intends to do that, I take it.

Senator COUZENS. Let us go over it and make it shorter.

The CHAIRMAN. Is that all?

Mr. COOPER. I thank you.

Senator LAFOLLETTE. Mr. Chairman, there are other witnesses present who wish to be heard.

The CHAIRMAN. Who will you have next?

Mr. GROSS. Mr. Chairman, I want to present Mr. Herman L. Ekern, who I am sure can explain some of the legal phases of the situation and will answer any questions. I want to say after listening to the questions you have been asking that I do not believe there is any such thing as a purely farm mutual company, or a purely farm mutual because their business is so much interwoven with town business, that while it may be so construed by this committee, the various departments might get different views and give different constructions. For instance, if a farm mutual is doing 90 per cent farm business but writes 5 or 10 per cent town property business, it certainly could not be classed as a purely farm mutual. There is no such thing as a local farm mutual because the most of them do business over the boundary line of one county into the county contiguous thereto, and then they are district mutuals. And then, in addition, there are State mutuals of necessity. Cyclone and hail companies could not confine their business to one or two counties. They would be annihilated following any big storm if they tried to do that. You can see that it is necessary to have cyclone and hail business spread over a larger area. This is also true in connection with farm mutual writing fire insurance, or at least to a certain extent.

The CHAIRMAN. We will hear Mr. Ekern.

#### STATEMENT OF HERMAN L. EKERN, MADISON, WIS.

Mr. EKERN. Mr. Chairman and gentlemen of the committee, I appear with the others here who represent National Association of Mutual Insurance Companies, and also for the State Farm Mutual Automobile and a number of other casualty companies.

Right at the outset I will say that the Senate proposal would in my judgment introduce such uncertainty into the exemption of these companies that it never would be settled. An attempt to confine the exemption to farmers, to a county, a town, and local mutual has been made before, and resulted in great controversy which had to be settled by the courts in reference to the special provision in the revenue act of 1924.

Senator WATSON. Why does a farmers' mutual gotten up for the purpose of insuring farmers want to write insurance in towns? That is where the contention comes in, isn't it?

Mr. EKERN. They are practically compelled to do it. Any attempt at a distinction between farmers' mutuals and other mutuals has no basis in fact. Property will burn whether it belongs to the farmer,



or the home owner in the city, or whether it belongs to the big manufacturer. It does not make any difference. And the operation of the mutual company is identical in any case. It is just merely a matter of collecting enough money to pay expenses and losses.

Now, some companies, as Mr. Cooper stated, collect this money after losses are incurred and then pay it out. But it is the most expensive way. It is the worst method of transacting the insurance business, because it results in losses in collections, and discouragement to policyholders in a particular year when losses are excessive.

Now, then, farmers' companies, quite a large number of them, all of the larger ones, the mutual companies generally, have gone over to the basis of collecting their pay for the insurance in advance. Then you have it.

Now, gentlemen of the committee, no company should be penalized because it does that. And that is all that there is to this matter. When they collect in advance what do they do? They keep that money in trust for the policyholder who pays it, and dips into it as they need it for the payment of losses and expenses, and they try to accumulate enough to be so held so that there will be an excess on hand to meet any extraordinary losses and expenses. That is all there is to it.

These companies necessarily, in order to be safe, must collect from policyholders more than enough. There is not anybody who has the judgment to determine in advance exactly how much is enough.

Now, what are they going to do with that? When they collect more than enough, at the end of the year generally, or at other times, they determine approximately what they can safely return to the policyholders by way of the money they have held in trust for them and still continue their business safely. That is returned. That is a dividend to the policyholders resulting from the saving in the conduct of the business.

Here is the fact about these companies, and if you will just permit me to give the committee a little about the practical operation of them I think it will be illuminating. We have been doing business throughout the country, in addition to these farmers' companies, which, as stated by Mr. Cooper, insure farmers generally, and then some homes in villages and towns and cities where farmers move, and sometimes other properties, and we have thus furnished their insurance at a saving of anywhere from one-third to one-half or two-thirds the cost in the other companies. And we have the grain dealers and the lumber men that furnish insurance at a saving of 30 to 40 per cent, and sometimes a little more, of the cost in the regular companies insuring at the regular rates. And then we have the hardware dealers which furnish insurance, and have done it for years, at an actual saving of 50 per cent over that of stock-company rates to their policyholders. Then we have the great sprinkler mutuals, factory mutual insurance companies in New England, the companies that put into this country the best thing ever done for fire prevention, the automatic sprinkler, and put it all over this country against the opposition in the early days, or at least with little acquiescence, now, is my conception, from the companies that write the other kind of insurance.

Now, these companies save their policyholders and return to them annually 96 per cent of the amount they deposit.

Now, it was necessary for them to do that, because thereby they practically wipe out fire losses with this automatic sprinkler, that is a fireman on the job 24 hours in the day.

The CHAIRMAN. Did I understand you to say that the regular fire insurance companies objected to the use of these automatic sprinklers?

Mr. EKERN. Well, at least they were not enthusiastic about them in the early days.

The CHAIRMAN. Well, I will say that they were in favor of them in the early days so far as insurance in Provo, Utah, was concerned. In the matter of the woolen mills out there they told me if I did not put the automatic sprinkler in my rate would be increased.

Mr. EKERN. Was that a mutual insurance company?

The CHAIRMAN. No.

Mr. EKERN. Well, they probably told you that if you did not put them in your rate would be increased; yes. But this matter dates way back to the seventies, when the automatic sprinkler was first put in in New England.

Senator COUZENS. Are you pleading also for the big factory mutual insurance companies?

Mr. EKERN. Yes, sir; for all of them. I am not representing them here specifically to-day, I mean the factory mutuals, but I have acted for them, and I know their case very well, and I will say that they are the people who have really done more for fire prevention, for the safeguarding of property, in the United States than any others.

The CHAIRMAN. And I take it they have made a fair profit.

Mr. EKERN. They have not made a dollar of profit. And pardon me, Senator Smoot, for making that answer so positive, but that is the very point I wanted to make. None of these mutual companies which would come under the description of mutual, make a dime by way of profit. They take this money which belongs to their policyholders and hold it in trust for them for this specific purpose. It is true that they invest the money and that money earns some interest.

Senator COUZENS. But they pay no taxes on that?

Mr. EKERN. No, sir.

Senator COUZENS. Sould they pay taxes?

Mr. EKERN. No, sir.

Senator COUZENS. But every other investor should pay taxes.

Mr. EKERN. I will say that the Government gets more taxes because of these people insuring in these mutual companies than it gets out of all taxes on stock companies and all that the policyholders in stock companies pay by reason of carrying that kind of insurance. I think I can illustrate that and make it very clear to you: A stock insurance company under your law of to-day, and under this bill, pays a tax on its profits ascertained from its report made to the insurance department. When a stock company pays a dividend to its stockholders a stockholder pays no tax on that dividend, at least normal tax, so that there is one tax paid there.

Now, in the case of a mutual company—and I will say that that was discussed and threshed out in 1916 and 1918, and I sat all through that matter and in connection with the subsequent enactments of law. Suppose you tried to tax mutual companies in the same way, and then tried to follow that saving in the mutual companies, and followed it

through to the policy holder, and say he shall deduct that saving and not pay a tax on it, the same as in the case of a stock company. It is wholly impracticable because the saving is combined with the return of the excess deposit that is made in order to make the company safe. So that instead of attempting to tax a mutual company, and such has been the law from the beginning, and it has been the intention of the law because these companies have not paid a dollar of tax since 1914 as far as I know, except when they paid the premium tax, which was a different proposition. That did not have anything to do with profits. So far as profits are concerned it has been recognized throughout by Congress that these companies are not profit-making companies, and that they have no profits that are subject to tax.

And let me follow your question a little further, Senator Couzens. When this money is returned to the policyholder, that money increases by that much the taxable income of that policyholder, and the Government because the policyholder took the insurance in a mutual company, gets a tax on that saving, which is a much greater tax and produces a greater revenue to the Government, especially in the case of these factory mutuals, which are the only companies this committee would consider taxing, and perhaps a very few of the largest of the other class of mutuals; and the Government gets a much greater tax from this money in the hands of the policyholder than it gets or could possibly get from taxing the insurance company on any basis comparable with that levied on stock companies.

Senator COUZENS. Why should we tax life insurance and not property insurance companies?

Mr. EKERN. There is a clear distinction. You gentlemen are probably all familiar with the way these insurance companies do business. Fire and casualty companies insure for a term of three or five years at the most. The money that is paid in by way of premium is just to cover the risk that may come from a loss. That is all there is to it. There is no certainty that that property will burn, or that a casualty will happen, during the term of the insurance; in fact, in the great mass of cases it does not occur. Now, in the case of life insurance, that is written on the basis of collecting from the policyholder an amount of money which is in excess of the amount required to carry the loss, and it matures the policy for the full face of it at age 96 in the case of an ordinary life policy, or in the case of an endowment policy it matures it into the full face before that time. A life-insurance policy is purely an investment trust, to enable the insurance company to have the difference between the amount accumulated in that investment trust and the face of the policy. That is all there is to it. And consequently it is entirely proper to tax life insurance companies, whether stock or mutual, so as to get a tax on those accumulations, which are entirely separate and distinct from those in casualty or fire companies.

Senator COUZENS. Could you tell me what happened after 1918? I believe you went back to 1914.

Mr. EKERN. I started with this matter in 1916, but I am familiar with it.

Senator COUZENS. The record shows that in 1918 mutual companies had, when we were talking about putting an excess-profits tax in the income tax law, \$1,472,696. And in 1919 it was \$1,800,640.

Then in 1923 it was \$122,000. And in 1921 it was \$711,000. And in 1922 it was \$170,000. And now it has gone down to nothing.

Mr. EKERN. Does this exclude refunds?

Senator COUZENS. These are the figures given here.

Mr. EKERN. They are not net figures?

Senator COUZENS. These are figures paid to the Government.

Mr. EKERN. Large amounts of those were refunded.

Senator COUZENS. Is that your understanding, Mr. Parker?

Mr. PARKER. As to some of them.

Mr. EKERN. Large amounts of them were refunded. And others were collected and retained because of some State interpretations of those deducting provisions, that they did not apply in those cases to casualty companies. As to the casualty company deduction the application was only applied later. Casualty companies were introduced into the exemption in 1924 at the instance of these mutual companies, and I think in the matter of deduction there was some controversy over it for some time, during the years you speak of. But the tax that was paid by those companies, that amounted to nothing through the premium tax.

Senator COUZENS. Well, I understand that the city companies, the people that are insuring in the cities and with stock companies, they are supposed to pay a tax. And as to the others that are insured in the mutuals they are not supposed to pay a tax, is that correct?

Mr. EKERN. No; that is not correct. A stock company pays an income tax.

Senator COUZENS. Yes.

Mr. EKERN. On its net profits, not on its business. I mean if it has any net profits. If its investments go down, or if it has excessive losses, it does not pay any tax.

Senator WALSH of Massachusetts. The same as any other corporation.

Mr. EKERN. You wont' have any companies to pay any tax this year, I am sure. Now then, mutual companies do not pay any tax. However, the stockholder in a stock company who gets a dividend, who gets a profit in a stock company when there is one, he pays no tax on that dividend. But when the mutual company policy holder gets his dividend, that increases by just that much his taxable income.

Senator COUZENS. And if he has a loss it does not tax him at all.

Mr. EKERN. No; but if it swells up his income he does. But that applies to anybody. We can not assume that all manufacturers and all large merchants and grain dealers and hardware dealers are operating at a loss and will pay no taxes. Or if that were true of them it would be true of all.

Senator COUZENS. We have heard that many of them are not going to pay any income tax.

Mr. EKERN. I am arguing the principle of the thing.

Senator WALSH of Massachusetts. Is the payment which a policyholder in a mutual company receives taxable in his income?

Mr. EKERN. Yes.

Senator WALSH of Massachusetts. Then what difference does it make about his having his dividend back? He deducts what he pays in, and then when the dividend comes to him it becomes a part of the profits of the company or the individual and he then pays a tax upon it.

Mr. EKERN. Yes.

Senator WALSH of Massachusetts. But the Government gets very little by that.

Mr. EKERN. The difference is this: Let us suppose that you have a hardware dealer who insures in a stock company. He pays \$100 premium, or in order to make it a little stronger let us say \$1,000. He does not get back a dollar of that money.

Senator WALSH of Massachusetts. I understand the difference between a stock company and a mutual company. As I understand in a mutual company a man who pays \$1,000 premium has that as deductible, and then if he gets back \$800 he pays a tax on the \$800.

Mr. EKERN. In the case of a stock company he would deduct the full \$1,000, and consequently he would pay a tax on \$800 less than he pays a tax on if he insures in a mutual company, and the Government gets the revenue. That revenue that the Government gets in the case of the stock company is a very small amount, because the truth of it is that the net profits of the stock companies are very small, and the mutual companies by reason of their selection and economy of operation are able to return a great deal more by way of savings, incomparably greater than the profits in the case of a stock company. There is no question about that.

Senator WALSH of Massachusetts. I think you are right, that in the end the Government gets more out of a policy holder in a mutual company than in a stock company.

Mr. EKERN. There is no question about that.

Senator COUZENS. Well, I think there is considerable question about it.

Mr. EKERN. There are no statistics to prove otherwise, and statistics on that point would be extremely difficult to figure out.

Senator COUZENS. Therefore, it is all a guess, and one can take either side he likes.

Mr. EKERN. No; I am not making a guess that it is a guess, because it is absolutely certain that the Government has returned to the policyholder. There is no question about that. The only question arising to guess about is, how many policies are there in the way of a tax; how many policies are there that the Government will get all off and pay no taxes. There is no doubt that we want to know, at some formal time, prior to 1929, how many policies there were which would be paid by policyholders on these savings, and how many policies there were which would be paid by stock companies. This is the kind of thing that we want to know.

Now, there is one other point that I want to emphasize, and that is this, that the mutual companies do a wonderful service to the Nation in the fire-prevention work they do, and in the great economies they furnish in the matter of insurance in their competition with stock companies in the matter of insurance. They not only benefit the policyholders, but by reason of the competition they give to the matter of insurance generally.

Senator WALSH of Massachusetts. How many mutual companies are there?

Mr. EKERN. There are about 2,000 mutual companies in the United States, I believe. Mr. COUZENS. I will not answer that question.

Mr. COOPER. Two thousand and nine.

Senator WALSH of Massachusetts. Do they take all kinds of risks, or are they confined to factories and mills and industrial plants?

**Mr. EKERN.** Different kinds of companies are generally organized to confine their insurance to particular kinds of business or particular classes of risks.

**Senator WALSH** of Massachusetts. And there are some mutuals that confine their business to dwellings.

**Mr. EKERN.** Yes, sir; to dwellings in cities and in the smaller towns. And then, of course, farm property outside of cities, and those same companies go into cities and towns and insure also dwellings and perhaps other property.

**Senator WALSH** of Massachusetts. Have you a record of how many stock companies there are?

**Mr. EKERN.** I should say offhand there would be about 500 stock companies now. But perhaps someone else present could answer that more authoritatively.

**Mr. GRUHN.** There are 600, counting the French, German, and English companies.

**Mr. EKERN.** The fact of the matter is, of course, that the great mass of these insurance companies, or, I mean the great mass of the insurance business, is done in stock companies, quite naturally.

**Senator WALSH** of Massachusetts. How much greater in percentage?

**Mr. EKERN.** Oh, in volume of premiums it used to be about 85 per cent in stock companies and 15 per cent in mutuals. But in actual amount of insurance in force—that is, in the way of property covered, because of the predominance of these mutuals that insure factories—about half of the property values are covered by the mutual companies. Is that right approximately, Mr. Freeman?

**Mr. FREEMAN.** I think that is too much.

**Mr. COOPER.** More than half of the farm stuff is in mutuals.

**Mr. EKERN.** It is a much larger amount of insurance in force than the premiums would indicate because of the lower rates and also because of the superior class of property which they generally insure.

Now, the reason that these companies are asking for this particular kind of amendment is this: In the first place, the deduction as I have stated has been applied so that, with comparatively few exceptions, it has resulted in a payment of no tax by these companies, and my recollection is that the factory mutual companies have never paid any income tax, that this large class of mutuals have never paid any income tax. Also, generally that the farmers' companies have never paid an income tax.

Now, I am speaking of the net payment made by these companies. The Treasury Department in a number of cases during certain periods has attempted to collect a tax from these companies, and they have been compelled to pay, and then they have filed claim for refund, I believe in nearly all cases the refunds have been allowed and repayment made.

Now, I have not access to the Treasury Department's records and I can not tell how much is covered by that. But I was counsel for some groups represented here for years, and I am very familiar with their operations, and know that they did not pay any tax.

**Senator COSTIGAN.** Have you provided a form of amendment that you recommend?

**Mr. EKERN.** Yes. The one that has been handed to the committee reporter.

Senator WALSH of Massachusetts. Read it again. Is it a short amendment?

Mr. EKERN. Yes; it is very short.

Senator WALSH of Massachusetts. Please read it again.

Mr. EKERN. What we are proposing is, to have you adopt an amendment in place of subsection 11, of section 103, page 63, lines 10 to 15 to read:

(11) Mutual insurance companies, including inter-insurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies.

In other words, this would declare the same kind of exemption for mutual insurance companies as is declared in the present law as to mutual savings banks or building and loan associations or any other of the strictly mutual organizations which are now exempted under the present law and always have been.

The reason we are asking for that kind of amendment is this: The Government does not get any revenue out of this. There has been in force all this time a deducting provision under which these companies are permitted to deduct the amounts that they carry over in trust for their policyholders.

Now, the only case, or cases, and there may be some such, but the only case where there would be a profit in these companies would be a case where the investment of a company produced money in excess of its losses and expenses. Those cases are in the courts and of course that is a different proposition entirely, when these companies that are mutual strictly in the sense of handling funds in trust and using them for payment of losses and expenses, obviously they don't have any profits, because if there is any gain from interest all that sort of thing is applied to the payment of losses and the rest is returned to the policyholders, and as I have stated before, becomes taxable.

Now, the proposal of the Senate would instead of permitting this exemption limit to be known as farm, county, town mutuals. The Treasury Department has been in the hundreds of thousands of dollars. These are the offices of these companies that cost the hundreds of thousands of dollars and even more.

Senator WALSH. The House bill take care of this.

Mr. EKERN. I believe it should be interpreted.

Senator WALSH. Will you want the language clarified?

Mr. EKERN. We have done this. I think Senator Walsh is right. This, as you know, was passed in 1918 Congress. It was amended in 1918 for mutual insurance companies, by adding provisions for mutual ditch irrigation companies and other organizations of a similar character. The Treasury Department in 1921 and carried them out. In 1921 Commercial Health & Accident Co. v. Pickering, a case of a health and accident company doing a State-wide business, and that was in the

State of Illinois, the court held that that company was not a local organization, and properly so. There is no doubt about that. And they held furthermore that they were not entitled to an exemption as a like organization, not being a local company. Now, these casualty companies were not mentioned in the exemption clause at that time.

I want to make this absolutely clear because this history is important. These casualty companies were not mentioned. Consequently if health and casualty companies were to be exempted it must be because a like organization of a purely local character. Now then, the court very properly held it was not exempt. In discussing this matter, however, the court took up the entire section and used language that indicated the court thought all mutual companies and other companies mentioned in the exempting section had to be of a purely local character.

Senator WALSH of Massachusetts. Is the idea of profit completely eliminated from all mutual companies?

Mr. EKERN. It is.

Senator WALSH of Massachusetts. Then why should farmers or county or local mutuals be exempt and not all mutual companies?

Mr. EKERN. There is absolutely no reason. I think such an exemption would be unconstitutional or ought to be.

Senator WALSH of Massachusetts. You are sure that all mutuals entirely eliminate the idea of profit?

Mr. EKERN. We are sure of that. There is just one case that I mentioned where there might be an excess of income over losses and expenses, and which were not applied for.

The CHAIRMAN. The House Committee language after the word "farmers" is:

or other mutual hall, cyclone, casualty, or fire insurance companies or associations.

Mr. EKERN. That is the language of the 1926 act. And it was repeated in 1928. Now, let me finish this statement to you; I mean about the Commercial Health & Accident Co. v. Pickering. Immediately following that decision Treasury Regulation No. 69 was issued, and that regulation said that no company would be held as exempt unless it was of a purely local character. Now, that precipitated a great contest down here. These mutual companies all protested, and the thing that Mr. Cooper was describing here happened. It put the mutual companies to a great deal of expense and loss, and the Treasury Department likewise to a great deal of expense. The result of that was that in 1924, in the revision of the revenue act of that year, Congress took this matter into its own hands and provided specifically that these mutual companies should all be exempted under the 1918 act and the 1921 act. And not only that but they provided that the mutual companies should be refunded any taxes that they had paid. So that we had a different construction by Congress of its intention under these earlier acts. And consequently the following year, in the regulations issued, the Treasury Department stated that companies are exempted regardless of whether or not they are of a purely local character.

We then came down to the 1926 act, which is the present act. Here is what we complain about in addition to that sort of construction: In the present act, which you adopted in 1926, provided that



farmers, either mutual casualty or fire insurance companies, and casualty was inserted in 1921, included income which is used and held for the purpose of paying losses and expenses.

Under that wording the Treasury Department issued its ruling, and in that ruling it specifically held, and this I think we are entitled to the benefit of, article 522 of the regulation 69 of August 28, 1926:

The only prerequisite to an exemption under paragraph 11 of section 281 is that the organization must be mutual and that its income must be used or held for the purpose of paying losses or expenses.

The provisions of this article also apply to interinsurers.

This is what happened under that regulation: Then the Treasury Department proceeded to exempt these large mutuals. The factory mutuals were exempted. Whenever any of these larger mutuals applied for an exemption, and they were not exempted until they applied, then they were granted the exemption right and left, the farmers' companies and all of them.

Then there was some objection made in the Treasury Department. They tried to hold that the word "casualty" did not mean what insurance men understood it to mean, that it meant only companies transacting insurance on property. Well, of course that can not be justified on any basis, because the word "casualty" has a different meaning, and that includes all these different kinds of insurance, workmen's compensation, liability, automobile, and all of them. They held that health and accident was not a casualty matter.

Now, in another respect they went on and tried to hold that a company that held over money from one year to another was not to be exempted because the money was not used or held for losses and expenses. And as a consequence of the language of 1929 as I recall it they began to recall those exemptions and gradually recalled them, and then insisted that those companies which for three years had been making their returns and transacting their business on the theory that they were exempt, should make a return. Well, they made returns, and in those returns they made the deductions authorized by the other section, and those deductions were accepted by the Government except in cases where they felt the policyholder did not get a dollar of revenue. Now, if he got some revenue, or in the case of some companies that did not understand the law—and that is wrong. I think it is morally and ethically wrong. I think every taxpayer should be treated alike whether ignorant or informed as to his rights.

Now, that is the situation we face. Under the circumstances I submit to you Senators that these companies are entitled to have this law read so there will be no question about it. And it can be so written. It is a simple matter. It is exactly what you have done for savings banks of New England and New York. It is exactly what you have done for all building and loan associations throughout the United States.

Why, gentlemen of the committee, these companies are purely trustees. That is all they are. They are managing this business. For themselves? No, for the general good of the community.

I want to say further that there was some question asked here about salaries. I should like to have a careful comparison made of salaries in mutual companies and in stock companies.

**Senator WATSON.** You exempt here from taxation mutual insurance companies.

**Mr. EKERN.** Yes, sir.

**Senator WATSON.** Including interinsurers and reciprocal underwriters but do not include mutual life companies. Is there any difference between a mutual life insurance company and one of your mutual companies? Are they organized for profit?

**Mr. EKERN.** I answered Senator Cousins on that but did not quite nail it up. In the case of a mutual fire or casualty company the money is collected purely for the payment of losses that may happen during the year or a longer term and there is no money collected to buy that property. In the case of life insurance there is enough money collected not alone to pay the death loss which may happen during the period of the policy, but also to accumulate enough to buy the face of that policy at whatever time may be specified, at age 98 in the case of ordinary life, or a shorter period in the case of endowment, and that accumulation for that purpose is an investment trust held over a long period of time. It may be for a lifetime or longer, because most insurance companies provide that the death payment may be made to beneficiaries throughout their lifetime. That being the case whatever excess there is of interest, and that is the question you are passing upon now, it is actually gone. Now, it is practicable to tax that excess of interest in the life insurance companies. It is the only practicable place to tax it. That arises not because it is in life insurance companies, but because it is in the investment-trust business. I am not enthusiastic about the idea of taxing the life insurance companies, but there is a margin there that you won't get any tax on unless you get it in this way, which is an entirely justified thing from the matter of taxes on fire and casualty companies.

**Senator WATSON.** Are these mutual companies organized for profit?

**Mr. EKERN.** No. But life insurance company investment funds yield a profit.

**Senator GEORGE.** That is just what I was trying to ask you.

**Mr. EKERN.** In these mutual life companies there is a certain carryover in the service.

**Senator WATSON.** What was that?

**Mr. EKERN.** In case you drop your policy you forfeit a certain part of the reserve. You forfeit all of the accumulated surplus on the policy generally.

**The CHAIRMAN.** Not always.

**Mr. EKERN.** Yes; you do if you drop your policy and get extended term insurance. That is nonparticipating and consequently you get no surplus.

**The CHAIRMAN.** But if you reinstate it half way during the period in which you are allowed to do it, then you get it back.

**Mr. EKERN.** Yes. There is no doubt about that. But the percentage of reinstatements is small. So that there is a material profit there to life insurance companies, which does not obtain in other forms of insurance. There are a couple of grounds of distinction between life and casualty insurance, but I have taken much more of your time than I had intended.

**The CHAIRMAN.** We were glad to hear from you.

**Mr. EKERN.** I should be glad to submit a memorandum if you wish.

Senator LA FOLLETTE. I am informed the purpose in adopting this language was to reach the companies which have an excess of interest over and above losses and expenses. Are there many such companies?

Mr. EKERN. The only one I know positively about is one that is now in litigation. That is the only company in the country I know about. There may be two or three others. I do not think I violate any confidence by disclosing it. It is the oldest mutual life insurance company in the United States if not in the world, and was founded by Benjamin Franklin. They are entitled to have this matter tested out. We ought to leave them alone and we are not entering into that.

The CHAIRMAN. Thank you.

Mr. EKERN. There is one other point. On that Senate amendment to section 208, the Senate proposal is that there be substituted for the present deduction of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves, this language:

The amount of premium deposits returned to their policyholders, and, unless otherwise allowed, a reasonable net addition to reinsurance reserves.

Now, if the members of the committee will turn to page 156 you will note that on line 9 there is provided already a deduction of "the net addition required by law to be made within the taxable year to reserve funds."

That gives all the deduction that may be given by this language, and in addition it probably would deprive these companies of deductions of reserve funds in the bill, because it would give to the Treasury Department the power to hold that these net additions to reserve funds were not reasonable even where the statute of the local State authorizes such deductions.

Senator LA FOLLETTE. I have been informed that was for the purpose of taking care of companies where the State law did not set up any requirement.

Mr. EKERN. There is no need of such a provision if you leave the House bill as it was. And I will say that we spent weeks and months in 1916 in attempting to devise some other form of statement which would protect these companies against a tax on trust funds that they carry over purely for the payment of losses. And we were unable to devise anything because these companies collect the money through each day of the year. At the end of the year, on December 31, they make their return on a cash basis, as they do any carry-over, when this deduction would be subject to a tax, when the thing obviously is money that they hold in trust to pay losses during the next 6 months or 11 months of the year, and which should not be taxed. A part of the money that they hold in trust is money held as reserves. That is already deducted. A part of the money that they hold in trust is money that they hold that has been accumulated as surplus and that will operate as a refund.

Now, if that surplus is to be taxed, and I am quite familiar with the argument that is made, if that surplus is to be taxed it will drive these companies out of business, because the very purpose of that surplus that they hold over, particularly in the case of these New England factory mutuals, is to meet a situation such as they met in the Chelsea fire. And I am very sure if the Treasury Department

had gone back and investigated what happened in the Chelsea fire they never would suggest any discouragement of the carrying over of these surpluses, especially as there is always an accounting for such a surplus to the policyholders, and the policyholders get the money and pay their taxes.

The CHAIRMAN. What is the reason for the increase of surplus from 1914 of about \$60,000,000 to 1927 when it was \$182,000,000? That is a 300 per cent increase in surplus.

Mr. EKERN. That is perfectly plain.

The CHAIRMAN. What is it?

Mr. EKERN. In 1914, as the Senator will recall, the country was in the dumps. Then the war broke out. Prices skyrocketed, and all these mutual companies wrote enormous amounts of business on the increased values and collected enormously increased amounts. Let me show you what that surplus represents.

Senator WALSH of Massachusetts. And you of course had to pay increased amounts in case of loss.

Mr. EKERN. Yes; but losses were favorable.

The CHAIRMAN. And losses were taken care of.

Mr. EKERN. If you will permit me, as you know, the amount of money involved in all kinds of businesses to-day is probably three or four times what it was in 1914. It is materially above what it was then. Here is what happened: These mutual companies insure a manufacturer. They collect from him \$1,000 premium. They carry that over at the end of the year. Under the Massachusetts law, which is recognized in every State of the Union, they put up at the end of the year \$500 of reserve, but as a matter of fact their total loss, if they ran six months, would only be \$20 or \$30 out of the \$1,000. The result of it is that that company has \$470 which it carries over at the end of the year in surplus. But on June 30th that company pays to that policyholder back not only the \$500 reserve that it put up but \$460 more, making a total of \$960, which it carries as a trust fund, and on top of that pays the losses for the next six months.

The CHAIRMAN. And with all of them you have about \$285,000,000.

Mr. EKERN. Do you mean the sprinkler mutuals?

The CHAIRMAN. All that are provided for in this bill.

Mr. EKERN. That may be. I would not be surprised if it was more.

The CHAIRMAN. That is admitted in the statement.

Mr. EKERN. Yes.

The CHAIRMAN. On that \$285,000,000 how much tax do you pay annually?

Mr. EKERN. I do not think any tax. But that is just a personal view. I do not know.

The CHAIRMAN. I am informed it is \$60,000.

Mr. EKERN. Well, I think it is \$60,000 too much. There is no doubt about that.

Senator COUZENS. Is that \$285,000,000 piled up in bank somewhere to be checked against, or do you invest it and make a profit out of it?

Mr. EKERN. Well, they necessarily invest it.

Senator COUZENS. Well, if you invest it and make a profit out of it do they pay a tax on that profit, or is that exempted, too?

Mr. EKERN. They pay no tax. That is not a profit to the insurance company but belongs to the policyholder and goes back to him when

he gets his distributive share, and that is subject to tax. Whereas, if it were returned as a dividend in the case of a stock company there would be no normal tax paid in any event. I am talking about the present law. That is the reason why I say there is no tax on these mutual companies, and there ought not to be any.

I thank you gentlemen of the committee.

The CHAIRMAN. Mr. Ekern, I should like to have a representative of the Treasury Department to make a statement while you are present.

Mr. EKERN. I will remain in the room.

#### STATEMENT OF H. P. FREEMAN, VICE PRESIDENT ASSOCIATED FACTORY MUTUAL FIRE INSURANCE COMPANIES

Mr. FREEMAN. I should like to say that the surplus comes not from excessive earnings, but from what the stock market does to us in the way of enhancement of values. [Laughter.]

The CHAIRMAN. And that is wiped out.

Mr. FREEMAN. Yes, sir. I do not like to admit this; this paper I now hand to the chairman shows it.

The CHAIRMAN. Well, that does not require any argument to prove it.

Mr. FREEMAN. When the Treasury Department saw those big figures in 1929 they thought we were pretty wealthy. But if we had not those figures then we would be in the soup to-day. A reasonable addition each year to surplus is necessary in order to take care of conflagrations as they come along. We insure the larger industrial plants of this country. Take for instance plants like the General Electric Co., and we have \$165,000,000 of insurance there, and probably in one group of buildings \$30,000,000. In order to meet that we have to have a great deal more in the way of assets than do the farm mutuals. So that our figures do look big to the Treasury Department and others who do not understand our methods, but they are not out of line with the size of the business we do.

Senator WALSH of Massachusetts. What is your company?

Mr. FREEMAN. The Associated Factory Mutual Fire Insurance Companies.

The CHAIRMAN. So far as the taxes are concerned that were paid in the past they are not large. Now, does anybody else wish to be heard?

Mr. GROSS. I should like to have Mr. A. B. Gruhn, of the American Mutual Alliance, representing a number of companies all over the United States, to be heard.

#### STATEMENT OF A. V. GRUHN, REPRESENTING THE AMERICAN MUTUAL ALLIANCE

Mr. GRUHN. I represent the American Mutual Alliance, composed of companies organized in every section of the country. And I represent also in this hearing a large group of farm companies.

I know that you expect me to cover only that which has not been covered before, and I am going to respect your wishes in that regard.

I am extremely sorry that this important matter comes so late in the session that it is impossible to present in the short space of time

allowed a great many facts which you ought to know about a great many companies, middle-class companies, so to speak, which would be crushed in between the favored few and the aristocrats of the business, if it is your intention in changing the law to reach only a few companies, and which would result in grave injustice being done to a great many companies, some of which are local in character. Many of these companies would pay unreasonable taxes under this amendment.

The mutual fire and casualty business represents, from all statements made to insurance departments or in Best Reports, about 10 or 15 per cent of the total volume, although in number of companies, as has been stated, and we have 2,509.

Early in the hearing the question was raised why the Senate amendment to section 103 of paragraph 11 did not exempt farm companies, and I think I can show by the Treasury expert's own words, which I take it are verbatim in the report of the committee, that the amendment is not intended to include all farm companies.

I think I can show to you, and I wish I had plenty of time to do it, that the amendment to section 208, c-3, imposes an unjust tax on a great many companies, a tax way out of reason as compared with competing companies operating on a profit basis.

I can show you where under the broad amendment of 1926, which the Treasury Department says exempted all farmers' mutual companies, that within the last two years or three years they have denied the exemption to farmers' mutual companies not very extensive in their operation as to territory, and have collected taxes from a few companies. Claims for refund have been made and in connection with one or two cases they are still pending and the moneys collected have not yet been returned.

I have a number of instances here that I might cite. There is a company in Kansas, a strictly farmer's company, that was examined by the agent and assessed \$3,000 in taxes. And at the agent's suggestion they signed an agreement to pay the tax, and a claim for refund of course is pending now and has been I think for a year or more.

I want to call the attention of the committee to the fact that the present deduction section, paragraph 208, section c-3, has been the governmental policy for 19 years; that it is substantially the wording of the 1913 and 1916 and 1918 and 1921 and 1924 and 1926 and 1928 acts.

I want to show you that of the mutual fire companies in Massachusetts not one would be exempted under the Senate amendment, no matter whether a comparatively small company or a comparatively large company.

I would want to show you where companies in Wisconsin, Pennsylvania, and other States, particularly local in their operation, would be considered as class companies subject to a tax on the amount of premium income held over at the end of the year, at the rate of 14 per cent, even though that income might be used within the next year to pay losses and expenses, the purpose for which it was set aside.

The CHAIRMAN. Isn't a fact that mutual life insurance companies now pay a tax merely on the interest, dividends, and rents collected?

Mr. GRUHN. I believe that is so.

The CHAIRMAN. Wouldn't that be fair to the mutuals?

Mr. GRUHN. I do not think so. The bill does not do that.

The CHAIRMAN. I know that, but I am asking for your opinion now, why should mutual life insurance companies be treated entirely differently from these others?

Mr. GRUHN. I think Mr. Ekern covered pretty fully the difference between a mutual life company and other mutuals. I am addressing myself to a class of companies which are comparable to mutual savings banks and which in my opinion should be treated as they are.

The Treasury Department in 1924 considered the proposition of taxing the income of mutual fire and casualty companies, and made an attempt at that time to go through with their plans. They heard various interests on that question and came to the conclusion that if that were done there were many cases where companies would pay a tax on investment income when they were operating at a loss, at least in some years.

The CHAIRMAN. Mutual life insurance companies pay a tax?

Mr. GRUHN. Their opportunities for operating at a loss are not at all as great, or not at all comparable with the opportunities that fire companies have of the possibility of unusual and heavy losses, and of operating at a loss during any one year.

I can show you, Mr. Chairman, where the Treasury Department in 1928 said that the surplus held by certain companies for conflagration and for reserves were way out of reason, whereas to-day those surpluses must be restored if the companies are going to be permitted to operate under the laws of some States.

Now, the class of companies doing business in Massachusetts and Pennsylvania and a good many of these States of which I speak, are required under the laws of certain States, in order to be permitted to do business there, to maintain unearned premium reserves, to maintain surplus accounts. And when those surplus accounts are below a certain standard they must be restored.

Now, I said I would prove to you that the exemption which was presumed to be given to farmers' companies under the Senate bill does not do that. And I am going to read from the committee report with respect to section 103 (11): (reading)

Sec. 103(11). Exemption of mutual, hail, cyclone, casualty, or fire insurance companies.

The provisions of the existing law if subject to the interpretation sometimes contended for would result in the exemption of virtually all mutual property insurance companies without regard to their character or manner of organization and operation. Thus it is contended that the phrase "or other" following "farmers'" does not restrict the exemption to those companies which are similar to the type commonly known as farmers and that this phrase in fact embraces practically all mutual property insurance companies which are not farmers' companies. It is also contended that the clause in the existing law requiring the income to be "used or held for the purpose of paying losses or expenses" is complied with by all mutual companies, since all such companies are at least in principle required to hold all of their income for the payment of losses (present or prospective) and of expenses. In order to state more clearly what your committee believes to be the true policy underlying the exemption of mutual insurance companies of this general class the bill confines the exemption to companies of the type commonly known as "farmers," "county," "town," or "local" mutuals, with the same limitation as in the existing law that the income must be used or held for paying losses or expenses. The use of the words "farmers," "county," etc., as modifying the word "mutuals" is not intended to describe or denote different types of mutual insurance companies but rather to

indicate some, if not all, of the designations employed in the several State statutes to denote the same general type of mutual insurance companies. Companies of this type are almost without exception organized under statutes which restrict the territorial scope of their operations and also their manner of organization and operation so as to preserve their truly mutual character.

That means without question that the Treasury Department has in mind exempting only farm companies of a purely local character. When you have farm companies, many of them operating on a state-wide basis or beyond the borders of one State, and into several States, that assess in one year for enough to take care of their needs for three or four or five years, for a time they will have what the Treasury would consider excessive amounts, and on which they would under this bill have to pay a heavy tax.

Now, I have a memorandum here which indicates that the chairman of the committee desires a representative of the Treasury Department to have whatever time is left, and I want to respect that wish.

I want to point this out to you first, however: I want to take Massachusetts again as an example. We have a group of fire companies, not factory mutual companies, but general writing companies, collecting premiums in advance and putting up unearned premium and loss reserves and setting aside small accumulations to surplus for conflagrations, and they returned, 16 of them, over \$40,000,000 to their policyholders in the form of savings, a large part of which has undoubtedly been taxed; many of the companies are 100 years old, and a great many of them over 50 years old, and which to-day have not a surplus account of more than \$200,000. They operate in the New England territory, but would nevertheless be taxed even though the savings banks in that territory hold surpluses which are not taxed.

I am sorry I have not the time to describe the conditions of a great mass of these middle-class companies that would be affected by any amendment that you introduce in order to reach some of the larger companies. If this matter had been brought up early in the session, and the Treasury Department had made its recommendations at the time when all other recommendations were made, at the beginning of the hearings before the Ways and Means Committee of the House of Representatives, we would have had some opportunity, the same opportunity as other interests, over this period of time, to make clearer to Congress the situation affecting these various groups of companies.

I appreciate the Senate committee giving us this hearing, and I further appreciate that your time is limited. I am sorry that we can not cover the thing as I think it should be covered. And for that reason, if for no other reason, I think it would be only fair in order to avoid injustice to a large group of companies which I represent, small companies many of them, that the bill as it came from the House, which is the present law as far as exemptions are concerned since 1926, and the present law as far as deductions are concerned since 1913, should be retained.

Mr. EKERN. How about our amendment?

Mr. GRAHN. Of the amendment. I have no objection to the amendment if it will clarify the exemption to all companies, and with that I am perfectly in accord.



But in any event if the Treasury feels differently about this matter, at the next revision, why, then give us the same opportunity and the same length of time to consider all the various phases of what apparently is a complex and little understood question as affecting a good many companies, and in that way be sure that substantial justice will be done to everyone.

Now, I am hurrying along all I can, and am leaving the question with the feeling that I have not represented my interests adequately but I realize that you are pressed for time this morning, and that you desire the representative of the Treasury Department to be heard.

The CHAIRMAN. Did I understand you to say that the savings banks of Massachusetts do not pay a tax?

Mr. GRUHN. The mutual savings banks are exempted under the bill.

The CHAIRMAN. I thought you said the savings banks were exempted.

Mr. GRUHN. The mutual savings banks, mutual benefit associations, fraternal associations, and so forth, are exempt. I am not saying that mutual savings banks should be taxed, but I am saying that we are in the same category and should be treated in the same manner.

I thank you, Mr. Chairman, and gentlemen of the committee.

The CHAIRMAN. Is that all?

Mr. GROSS. We have with us Mr. Daniel B. Howell, of Kansas City, representing a number of reciprocal underwriters. If you have a moment, we should like you to hear him.

Senator WATSON. Are they not all in the same class?

Mr. GROSS. They are all under the same law.

Mr. HOWELL. They have some different problems arising under the bill.

The CHAIRMAN. We will hear Mr. Bartholow now, and hope we will have time to hear Mr. Howell before we close.

#### STATEMENT OF B. H. BARTHOLOW, SPECIAL ASSISTANT TO THE SECRETARY OF THE TREASURY, WASHINGTON, D. C.

Mr. BARTHOLOW. Mr. Chairman and gentlemen of the committee: I want to call attention to the change in the language in this exemption provision on page 63 of the bill to be known as the revenue act of 1932.

The main purpose of this amendment is to bring into the class of taxable corporations those large factory mutuals and not to affect in any manner the so-called farmers' companies.

Now, that might have been done by merely omitting the words "or other" as it stands in the present law, so that the section would have read:

Farmers' mutual hail, cyclone, casualty, or fire insurance companies—

And so forth. But it was felt if that language alone were used someone might contend that it was only companies made up of farmers that were entitled to the exemption.

Senator METCALF. Why don't we change the name of these factory mutuals to farmers' factory mutuals and then they would come within the same category as farmers.

Mr. BARTHLOW. Well, as I understand, the word "farmers" is used to denote a certain kind of insurance company, usually local in character, although they do not have to be confined to a town or a county, but may operate in contiguous counties. And under the most of the State laws these small insurance companies are provided for with certain restrictions, such as they can not do business in towns exceeding a certain number of population, and so forth. But there is no area purpose at all in that, because one of these local companies may go over county lines, and it would thereby lose its exemption. These companies for the most part I am informed are organized under special State statutes looking toward this particular type of company. As long as a company is organized under one of these State statutes, the extent to which it does business, so far as the matter of legality is concerned, would be wholly immaterial.

As a matter of fact, the language in here when we say "farmers," "county," "town," or "local," was put in so that there could not be any contention that it was restricted to companies made up solely of farmers.

In hunting for what language we should use I will say it was taken out of Hagner's Book on Property Insurance, in which he says:

The best examples of this type are the so-called local mutuals, county, town, or farmers' mutuals, of which there are fully 2,000 in the United States, with a total insurance in force of between five and six millions of dollars.

Now, the very language there is the language which we adopted in merely trying to specify the type of organization, because the language says "of the type commonly known as."

In other words, it does not have to be an organization made up of farmers or doing business in one town. It is the type of organization which the statute specifies. A good deal of thought was given to this language, and this was the best language which the committee could find in order to express the thought which was adopted by the Finance Committee.

Senator WALSH of Massachusetts. Is it the thought of the Treasury Department in writing this exemption, or is it based upon the theory that it desires to exempt mutuals or that it desires to exempt small groups and farmers' mutuals?

Mr. BATHLOW. Generally speaking, the latter, because the Treasury Department does not believe that just because a company is a mutual company it is entitled to the exemption any more than in the case of a life-insurance company. It is true that certain distinctions have been mentioned, but as far as taxability is concerned the Treasury Department sees no reason why the life-insurance company and the property of the insurance company that does a great business through a number of States and builds up very substantial reserves should be exempt solely because it is mutual. The fact remains that even in these mutual companies if a policyholder leaves the company does he have given to him his share of the accumulated surplus? No. When he leaves the company that surplus goes on with the company, and it is for that reason that we believe the company should be treated as a taxable entity and taxed on those accumulations of surplus which it has.

Senator WALSH of Massachusetts. Isn't the same thing true of the small farmers' mutual company? When he leaves doesn't his accumulation remain?

Mr. BARTHOLOW. I understand from some of the statements made here to-day that these companies do business without having any specified reserves, or in the case of many of these farmers' companies I do not believe that the amount involved is more than negligible. While it is difficult to specify why one class should be exempt and another taxable, the fact remains that the bill does not attempt to so tax the small cooperative groups, which are usually local in character but as to which there is no necessity in the law that they should be confined locally.

Senator METCALF. Why do you exempt the small ones and yet you want to get after the big ones?

Mr. BARTHOLOW. As I have stated, it is very difficult to give any substantial reason for the distinction, except that in the case of the small companies if returns were required there would be practically no income and probably the cost of getting the returns would not justify the revenues collected.

Senator METCALF. In these factory mutuals that you have in New England, that surplus goes back to the policyholders. It is not kept in the company.

Mr. BARTHOLOW. It goes along with the company, and as policyholders change the old policyholders drop out and lose any claim to that surplus.

Senator METCALF. That surplus is returned every year, whatever it amounts to.

Mr. BARTHOLOW. As much as is returned only is allowed under the deduction section to be taken as a deduction by those companies. In other words, the amounts of premiums which are actually returned to policyholders are not taxed to the company. It is the amount left in the company to accumulate as a surplus toward which this tax is directed.

Senator WATSON. What do you think of this amendment that is proposed?

Mr. BARTHOLOW. Well, this amendment suggested here is an out and out exemption to all mutual insurance companies other than marine and life, and for no reason that I know of. Naturally this would not be subject to any difficulties because it exempts the whole world. The only question is: Are you a life or marine mutual, and if so then you are entitled to the exemption.

Senator METCALF. Might Mr. Freeman ask a question, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. FREEMAN. In regard to the surplus, I should like to explain that where there is any in our company, and in my own office, and it is about on a par with the other companies, it is 97½ per cent. That is the total amount available that we can return to the members, and we are paying 96 per cent. Surely it can not be argued that the 1.6 cents we put aside to meet conflagrations is excessive. The rest of the surplus comes from appreciation in security. At the present time this fund we have been building up to take care of conflagrations has been used to meet stock-market losses.

The CHAIRMAN. You do not think we ought to legislate to meet those losses, do you?

Mr. FREEMAN. No. But I do not want the committee to get the impression that we are building up tremendous surpluses. Our sur-

plus at the present time is based on the one and a half per cent of the insurance in force. I can not see any difference between the small company and the mutual. As long as the profits go to anybody, I do not see why we should not be exempt.

Senator WALSH of Massachusetts. Why not, instead of picking out the farmers and local mutuals, consider making such demarcation as between taxable and nontaxable mutuals, the companies that do a certain volume of business.

Mr. FREEMAN. Well—

Mr. BARTHOLOW (interposing). That distinction is possible, but maybe Mr. Parker has given some thought to it. Maybe some line could be arrived at more satisfactorily through that means.

Mr. PARKER. Before I answer the question let me say I thought there was a distinction between the small farmers' mutual and these larger factory mutuals. It is well known that the farmers' mutual, if this interest is accumulated on the surplus, is distributed. That is, if the company is a trustee for the beneficiaries of the trust, they would save the tax on the interest. The farmers are not generally taxpayers, because they do not make enough money. When you come to the factory mutuals, unless the large companies, they get the benefit of every dollar of interest earned by the big companies. You have a different type of people in them.

I want to be sure I get your question, Senator Walsh, before I attempt to answer it.

Senator WALSH of Massachusetts. I can conceive of some of these farmers and locals doing a large volume of business, the same as the mutuals that have been referred to throughout the country that take care of and protect homesteads and factories. Why couldn't you make a difference like this, instead of exempting the farm local and county mutuals, fix the volume of business as being the line of demarcation between nontaxable and taxable mutuals?

Mr. PARKER. An arbitrary distinction?

Senator WALSH of Massachusetts. Exempt the small companies and let all other companies pay the tax.

Senator WATSON. Wouldn't that be unconstitutional?

Senator WALSH of Massachusetts. Well, we exempt small taxpayers. We give certain exemptions to married men and single men. We make exemptions all along the line differently. In the sales tax provision of the House bill they exempted those doing a volume of business less than \$20,000.

Mr. PARKER. For many years we have exempted all corporations of \$2,000, and in case of insurance companies it is \$25,000. That would do it instead of this other way. Yes; I think that could be done.

Senator WALSH of Massachusetts. The distinction here seems to be one of names. They are all mutual companies, but certain ones with certain names are exempt and others are not. If your idea is to exempt all small companies let us put them out because of their small business rather than because of their name.

Mr. PARKER. I think if you can have a specific exemption to apply to all mutual companies, the big ones as well as the little ones, you would get rid of any constitutional objection. You would be giving a specific exemption, so that that exemption would be more to the net income of the small companies.

Senator WATSON. Aren't there some very large farm mutuals? Who can answer that question?

Mr. EKERN. There are some of the largest automobile insurance companies in the United States that are farm mutuals. They are not exclusively that, but perhaps 95 per cent of their business is with farmers, so you can not make that distinction.

Let me make this suggestion, and I am making it, I think, in the interest of the Government saving some money: Any line you may draw on this exempt class won't cut any figure at all because all you will do is to merely turn around and make the larger companies make one and they make a deduction and pay no tax. Any just law that you enact will permit deductions, as under the old law.

Mr. PARKER. I can not agree to that. You are getting the same deduction over and over again.

Mr. EKERN. If you will pardon me for a moment, and I do not want to take the chairman's time. Here is the point on the question of doubling deductions. I want to leave with the chairman a brief that was filed with the Treasury Department, and it was approved by the Treasury Department in L. O. 1050, which settles that question.

I merely want to say further that as long as you do not grant an exemption you require reports to be made, and it imposes a very great expense to the Treasury Department with no revenue.

The CHAIRMAN. That is the way with every tax.

Mr. EKERN. It has been the case for 20 years.

Mr. BARTHOLOW. One statement on the second section, 208, and we have talked about section 208. Under the amendment some companies now exempt, the factory mutuals, would be taxable through the provisions of section 208, and in determining their tax liability, having gotten some of the companies into the taxable class it is necessary to make some amendment to this provision. I want to call attention to subsection (c), which says that these companies are entitled to all deductions allowed by section 23. That means that they can deduct all losses incurred and expenses paid. But the last part of section 208 says in addition to allowing them to take deductions for losses incurred and expenses paid, that they are entitled to an additional deduction for the amount of premium deposits retained for payment of losses and a reasonable net addition to reinsurance reserves.

Senator WATSON. Where are you reading?

Mr. BARTHOLOW. The last sentence of section 208. In other words, these companies would be allowed under this scheme to set aside moneys to pay losses in future years and deduct it then, and then in any year when they pay a loss out of the yearly fund they would deduct it, and so the losses would be deducted twice.

Even if a company were determined to be taxable under this scheme of taxation it would be almost impossible to get any company that would be taxable because these same amounts would be allowed as deductions when set aside, and secondly, when the losses were actually paid. This amendment therefore in section 208 is directed particularly to doing away with that double deduction.

Senator WALSH of Massachusetts. If I understand the complaint here it is that certain mutuals because of the name they bear are

given a preference over other mutuals? Isn't that the net result of this section?

Mr. BARTHOLOW. It is not only the names they bear but the statute under which they operate, and there are certain restriction limits. All these farmers' companies, which does not apply to the big companies, doing business throughout a number of States.

Senator WALSH of Massachusetts. Are we agreed upon that as being true? Is that a fact?

Mr. EHERN. No.

Senator WALSH of Massachusetts. You say that is in dispute. What these people want is to be all treated alike. If you are going to double the tax or triple tax them do it to all mutuals, small and large, and then if you are going to give exemptions to any give it to all, is that it?

Mr. EKERN. That is it exactly.

Senator METCALF. Wouldn't it under this law affect the big factory mutuals more than the stock companies because of the way they keep their surplus on hand?

Mr. BARTHOLOW. There are certain points which Mr. Freeman brought up in conference the other day which are well taken points as far as the Treasury is concerned, and there would be no objection to a certain amendment along the lines he suggested. In other words, we recognize that there are some situations where this section 208, not because of the amendment, however, would operate somewhat unfairly.

Senator METCALF. How would you remedy that?

Mr. BARTHOLOW. Well, Mr. Freeman was going to give some thought to preparing an amendment to section 208 to which we would give consideration. He has not as yet submitted a draft so far as I know.

Senator METCALF. That is the point I wanted to bring out.

Mr. EKERN. May we suggest that we had a conference on that matter. When we reviewed what had happened we were wholly unable to find any way that would do this in a more fair way than is done at the present time. The objection to any duplicate deduction is avoided by using the formula we have in this statement.

Senator WALSH of Massachusetts. I think the Treasury Department ought to be given an opportunity to read over this record and think about it and come to us with additional suggestions. I think they have been handicapped by some cases that have been put in by the opponents of the present recommendation of the committee.

Senator WATSON (presiding). Does any other Government expert want to be heard?

Senator WALSH of Massachusetts. I move that we adjourn.

Senator WATSON. Are you satisfied now, Mr. Gross?

Mr. COOPER. Our Farmers' Mutual Liability of Indiana, in order to take care of certain farm risks under the Indiana law, and it is the same thing in some other States, has to be organized under a different statute than the ordinary farm mutual, but if you determine it according to the law it is all right.

Mr. Gross. I understand Mr. Howell would like to say a word or two.

Senator WATSON (presiding). All right.

**STATEMENT OF DANIEL B. HOWELL, KANSAS CITY, MO.**

Mr. HOWELL. I appear for the reciprocal underwriters, blocked with the mutual companies here not because they are the same in form of organization, but because they do operate on what would be called the mutual plan. Now, there are a good many differences. One is that they are not incorporated. It is simply a cooperative group.

Senator WALSH of Massachusetts. A voluntary organization?

Mr. HOWELL. A voluntary cooperative group. You will observe that it would put the corporation tax upon individuals because the saving is by the individual, if any, or the interest earning is by the individual, if any, whereas there is applied the corporation tax.

All that has been said by General Ekern and the other gentlemen appearing here for the mutuals is applicable to us, and likewise what has been said with respect to the factory mutuals in the carry-over of unreturned dividends is applicable to us.

I am only addressing myself to particular matters. If you say return savings without any consideration of those returned savings, or return dividends, unless the dividends are uniform or the savings are uniform, you are going to have peaks and valleys in your deductions, and if you did that you will have times of deduction of purely cooperative concerns far in excess of what you would tax a stock company organized for profit.

So that when we undertook to work out that plan last week for these gentlemen, we found the greatest difficulty in it, and if Mr. Bartholow attempts it he will find the greatest difficulty in undertaking to reconcile a plan here in this short time that we have that will cover it, in these multifarious forms of cooperative insurance plans that are organized and maintained solely for the purpose of protecting the property of the policyholder and not for making profits, and in which there can be no profit. And the small accretions in surplus are returned under the reciprocal plan the very day the policy is canceled.

It is the Treasury Department's opinion that it is carried over and if a man drops out that is held. But that is not true. The policy expires the moment of the cancellation of the policy, so that there would have to be a provision for a return of these savings, otherwise you would tax us far in excess of stock companies.

Upon the whole my opinion is that the House plan should stand. It has been interpreted. It is the old law, and if you open it up you get into an unending squabble as to what the words you put in really mean. And there will be litigation.

I might say this, too, that the amendment offered by General Ekern is quite satisfactory to us. That is, either the House bill or the Ekern amendment.

Senator WALSH of Massachusetts. Mr. Chairman, I think the record ought to show before we close these hearings what the Treasury Department expects to receive in the way of revenue from this Senate amendment.

Senator WATSON. Will Mr. Parker state that?

Mr. PARKER. I do not think the Treasury Department has made an estimate. I made a rough estimate on a little different plan that I was working on, whereas we are getting now about \$60,000 I understand, I figured it would run somewhere in the neighborhood of \$1,000,000, somewhere between \$900,000 and \$1,000,000.

Senator WALSH of Massachusetts. Under the terms of the Senate amendment?

Mr. PARKER. Yes.

Senator WATSON. The committee now stands adjourned.