TAX FORMULA FOR LIFE INSURANCE COMPANIES

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HEARING

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-FOURTH CONGRESS

FIRST SESSION

ON

H. R. 7201

AN ACT RELATING TO THE TAXATION OF INCOME OF INSURANCE COMPANIES

JULY 25, 1955

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TAX FORMULA FOR LIFE INSURANCE COMPANIES

MONDAY, JULY 25, 1955

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to call, at 10:10 a. m., in Room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Smathers, Barkley, Millikin, Martin, Flanders, Carlson, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

We have before us this morning H. R. 7201. That will be made a part of the record at this point.

(H. R. 7201 is as follows:)

[H. R. 7201, 84th Cong., 1st sess.]

AN ACT Relating to the taxation of income of insurance companies

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act be cited as the "Life Insurance Company Tax Act of 1955".

SEC. 2. REVISION OF FORMULAS FOR TAXING INCOME OF LIFE INSURANCE COMPANIES

Part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954 is hereby amended to read as follows:

"PART I—LIFE INSURANCE COMPANIES

"Subpart A. 1955 formula.
"Subpart B. 1942 formula.
"Subpart C. Miscellaneous provisions.

"Subpart A—1955 Formula

"Sec. 801. Definition of life insurance company.
"Sec. 802. Tax imposed for 1955.
"Sec. 803. Income and deductions.
"Sec. 804. Reserve and other policy liability deduction.
"Sec. 805. Special interest deduction.

"SEC. 801. DEFINITION OF LIFE INSURANCE COMPANY.

"(a) LIFE INSURANCE COMPANY DEFINED.—For purposes of this subtitle, the term 'life insurance company' means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if—

"(1) its life insurance reserves (as defined in subsection (b)), plus

"(2) unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves,

comprise more than 50 percent of its total reserves (as defined in subsection (c)).

"(b) LIFE INSURANCE RESERVES DEFINED.—

"(1) IN GENERAL.—For purposes of this part, the term 'life insurance reserves' means amounts—

"(A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and

"(B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies.

"(2) RESERVES MUST BE REQUIRED BY LAW.—Except—

"(A) in the case of policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, and

"(B) as provided in paragraph (3),

in addition to the requirements set forth in paragraph (1), life insurance reserves must be required by law.

"(3) ASSESSMENT COMPANIES.—In the case of an assessment life insurance company or association, the term 'life insurance reserves' includes—

"(A) sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and

"(B) any funds maintained, under the charter or articles of incorporation or association (or bylaws approved by a State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued on the assessment plan and not subject to any other use.

"(4) AMOUNT OF RESERVE.—For purposes of this subsection, subsection (a), and subsection (c), the amount of any reserve (or portion thereof) for any taxable year shall be the mean of such reserve (or portion thereof) at the beginning and end of the taxable year.

"(c) TOTAL RESERVES DEFINED.—For purposes of subsection (a), the term 'total reserves' means—

"(1) life insurance reserves,

"(2) unearned premiums and unpaid losses not included in life insurance reserves, and

"(3) all other insurance reserves required by law.

"(d) ADJUSTMENTS IN RESERVES FOR POLICY LOANS.—For purposes only of determining under subsection (a) whether or not an insurance company is a life insurance company, the life insurance reserves, and the total reserves, shall each be reduced by an amount equal to the mean of the aggregates, at the beginning and end of the taxable year, of the policy loans outstanding with respect to contracts for which life insurance reserves are maintained.

"(e) BURIAL AND FUNERAL BENEFIT INSURANCE COMPANIES.—A burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services shall not be taxable under this part but shall be taxable under section 821 or section 831.

"SEC. 802. TAX IMPOSED FOR 1955.

"(a) TAX IMPOSED.—A tax is hereby imposed for each taxable year beginning in 1955 on the income of every life insurance company. Except as provided in subsection (c), such tax shall consist of a normal tax (computed under section 11 (b)) and a surtax (computed under section 11 (c)) on the sum of—

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

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

"(b) LIFE INSURANCE TAXABLE INCOME DEFINED.—For purposes of this subpart, the term 'life insurance taxable income' means the net investment income (as defined in section 803 (c)), minus the sum of—

"(1) the net investment income allocable to non-life insurance reserves (determined under section 804 (g)),

"(2) the reserve and other policy liability deduction (determined under section 804), and

"(3) the special interest deduction, if any, allowed by section 805.

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

"(1) IN GENERAL.—In the case of a life insurance company which has non-life insurance reserves, the tax imposed by subsection (a) of this section for any taxable year beginning in 1955 shall be the tax computed under such subsection (or under section 1201 (a) if applicable) or the tax computed under paragraph (2) of this subsection, whichever is the greater.

"(2) ALTERNATIVE 1 PERCENT TAX ON NON-LIFE INSURANCE BUSINESS.—

The tax referred to in paragraph (1) is a tax equal to the sum of the following:

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

"(B) A partial tax consisting of—

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

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

"(d) DEDUCTIONS FOR PARTIALLY TAX-EXEMPT INTEREST.—

"(1) COMPUTATIONS UNDER SUBSECTION (a).—For purposes of computing the normal tax under subsection (a), there shall be allowed as a deduction an amount which bears the same ratio to the amount of the deduction provided by section 242 for partially tax-exempt interest as (A) the sum of the life insurance taxable income and the net investment income allocable to non-life insurance reserves bears to (B) the net investment income.

"(2) COMPUTATIONS UNDER SUBSECTION (c) (2) (A).—In computing the normal tax for purposes of subsection (c) (2) (A), there shall be allowed as a deduction an amount which bears the same ratio to the amount of the deduction provided by section 242 for partially tax-exempt interest as (A) the life insurance taxable income bears to (B) the net investment income.

"(e) ALTERNATIVE TAX ON CAPITAL GAINS.—In the case of a life insurance company which has non-life insurance reserves, the term 'excess' used in section 1201 (a) (relating to alternative tax on capital gains of corporations) means, for purposes of section 1201 (a), an amount which bears the same ratio to the excess described in such section as the non-life insurance reserves (determined under section 804 (g)) bear to the qualified reserves (determined under section 804 (d)). For purposes of any such computation, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into account.

"(f) NON-LIFE INSURANCE TAXABLE INCOME DEFINED.—For purposes of this subpart, the term 'non-life insurance taxable income' means the net investment income allocable to non-life insurance reserves (determined under section 804 (g))—

"(1) increased by an amount which bears the same ratio to the net capital gain as the non-life insurance reserves bear to the qualified reserves; and

"(2) decreased by an amount which bears the same ratio to the total of the deductions provided in sections 243, 244, and 245 as the non-life insurance reserves bear to the qualified reserves.

In computing a net capital gain for purposes of this paragraph, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into account.

"SEC. 803. INCOME AND DEDUCTIONS.

"(a) APPLICATION OF SECTION.—The definitions and rules contained in this section shall apply only in the case of life insurance companies.

"(b) GROSS INVESTMENT INCOME.—For purposes of this part, the term 'gross investment income' means the sum of the following:

"(1) The gross amount of income received or accrued from—

"(A) interest, dividends, rents, and royalties,

"(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties, and

"(C) the alteration or termination of any instrument or agreement described in subparagraph (B).

"(2) The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

In computing gross investment income under this subsection, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

"(c) NET INVESTMENT INCOME DEFINED.—The term 'net investment income' means the gross investment income less the following deductions:

"(1) TAX-FREE INTEREST.—The amount of interest received or accrued during the taxable year which under section 103 is excluded from gross income.

"(2) INVESTMENT EXPENSES.—

"(A) Investment expenses paid or accrued during the taxable year.

"(B) If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed—

"(i) one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year, plus

"(ii) one-fourth of the amount by which the net investment income (computed without any deduction for investment expenses allowed by this paragraph, or for tax-free interest allowed by paragraph (1)) exceeds 3¾ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

"(3) REAL ESTATE EXPENSES.—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

"(4) DEPRECIATION.—The depreciation deduction allowed by section 167.

"(5) DEPLETION.—The deduction allowed by section 611 (relating to depletion).

"(6) TRADE OR BUSINESS DEDUCTIONS.—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner; except that for purposes of this paragraph—

"(A) There shall be excluded losses from—

"(i) sales or exchanges of capital assets,

"(ii) sales or exchanges of property used in the trade or business (as defined in section 1231 (b)), and

"(iii) the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business (as so defined).

"(B) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account.

"(C) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII of subchapter B, shall not be allowed.

"(d) RENTAL VALUE OF REAL ESTATE.—The deduction under subsection (c) (3) and (4) on account of any real estate owned and occupied in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

"(e) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—The gross investment income, the deduction for wholly-exempt interest allowed by subsection (c) (1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined—

"(1) in accordance with the method regularly employed by such company, if such method is reasonable, and

"(2) in all other cases in accordance with regulations prescribed by the Secretary or his delegate.

"SEC. 804. RESERVE AND OTHER POLICY LIABILITY DEDUCTION.

"(a) GENERAL RULE.—Except as provided in subsections (b) and (c), for purposes of this subpart the term 'reserve and other policy liability deduction' means the sum of the following:

"(1) 100 percent of the amount of the net investment income allocable to pension plan reserves (determined under subsection (e));

"(2) 95 percent of the amount of the net investment income allocable to reserves for annuity contracts and deposits (determined under subsection (f)); and

"(3) 85 percent of the amount by which the net investment income exceeds the sum of—

"(A) the amount of the net investment income allocable to pension plan reserves,

"(B) the amount of the net investment income allocable to reserves for annuity contracts and deposits, and

"(C) the amount of the net investment income allocable to non-life insurance reserves (determined under subsection (g)).

"(b) REDUCED PERCENTAGES DURING INITIAL PERIOD.—In the case of a taxable year beginning before January 1, 1960, the reserve and other policy liability deduction shall be computed by substituting for the percentages stated in paragraphs (1) and (2) of subsection (a) the percentages determined from the following table:

If the taxable year begins in—	The percentage shall be—	
	Paragraph (1)	Paragraph (2)
	Percent	Percent
1955	92.5	90
1956	94	91
1957	95.5	92
1958	97	93
1959	98.5	94

In the case of a taxable year beginning in 1956, 1957, 1958, or 1959, this subsection shall apply only if the tax imposed by section 802 shall have been made applicable with respect to such a taxable year.

"(c) MAXIMUM DEDUCTION.—

"(1) IN GENERAL.—The reserve and other policy liability deduction shall in no case exceed that amount which is equal to the sum of the following:

"(A) the amount equal to 2 times the amount determined under paragraph (1) of section 805 (c) (relating to required interest on life insurance reserves);

"(B) the amount determined under paragraph (2) of section 805 (c) (relating to required interest on reserves for deferred dividends);

"(C) the amount of the interest paid (as defined in section 805 (d)); and

"(D) the dividends to policyholders paid or declared (other than dividends on contracts meeting the requirements of section 804 (g) (2) (A)),

reduced by the amount of the adjustment for policy loans provided in paragraph (2) of this subsection. For purposes of subparagraph (D) of the preceding sentence, the term 'paid or declared' shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

"(2) REDUCTION FOR CERTAIN POLICY LOANS.—The adjustment described in paragraph (1) of this subsection shall be an amount equal to—

"(A) the mean of the aggregates, at the beginning and end of the taxable year, of the outstanding policy loans with respect to contracts for which life insurance reserves are maintained, multiplied by

"(B) the average rate of interest applicable to life insurance reserves.

For purposes of subparagraph (B) of the preceding sentence, the term 'average rate of interest applicable to life insurance reserves' means the ratio obtained by dividing the sum obtained under paragraph (1) of section 805 (c) by the sum of the means described in paragraph (1) (B) of section 805 (c).

"(3) DIVIDENDS RECEIVED DEDUCTION WHERE MAXIMUM LIMIT APPLIES.—

"(A) If paragraph (1) of this subsection reduces the reserve and other policy liability deduction allowed by this section or section 812 for the taxable year, then in computing life insurance taxable income under section 802 (b), and in computing life insurance company taxable income under section 811 (b), there shall be allowed an additional deduction in an amount determined under subparagraph (B).

"(B) The amount of the additional deduction referred to in subparagraph (A) shall be the amount which bears the same ratio to the total of the deductions provided in sections 243, 244, and 245 as the net investment income reduced by the sum of—

"(i) the net investment income allocable to non-life insurance reserves (or, for purposes of section 811 (b), the amount of the adjustment for certain reserves provided in section 813), and

"(ii) 100/85 of the maximum limitation determined under paragraphs (1) and (2) of this subsection,

bears to the net investment income.

"(d) QUALIFIED RESERVES DEFINED.—For purposes of this subpart, the term 'qualified reserves' means the sum of the following:

"(1) The life insurance reserves (as defined in section 801 (b)), plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

"(2) The non-life insurance reserves (as defined in subsection (g) (2)).

"(3) The amounts (discounted at the rates of interest assumed by the company) necessary to satisfy the obligations under insurance and annuity contracts (including contracts supplementary thereto), but only if (A) such obligations when satisfied will reflect an increment in the nature of interest, and (B) such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, health, or accident contingencies.

"(4) The amounts held at the end of the taxable year as reserves for dividends to policyholders, the payment of which dividends is deferred for a period which expires not earlier than 5 years from the date of the policy contract. This paragraph does not apply to dividends payable during the year following the taxable year.

"(5) Dividend accumulations, and other amounts, held at interest in connection with insurance or annuity contracts (including contracts supplementary thereto).

"(6) Premiums received in advance, and liabilities for premium deposit funds.

In applying this subsection, or in applying subsection (a), the same item shall be counted only once. For purposes of this section (other than paragraph (4) of this subsection), the amount of any reserve (or portion thereof) for any taxable year shall be the mean of such reserve (or portion thereof) at the beginning and end of the taxable year.

"(e) ALLOCATION OF NET INVESTMENT INCOME TO PENSION PLAN RESERVES.—

"(1) ALLOCATION RATIO.—For purposes of this subpart, the amount of the net investment income allocable to pension plan reserves is that amount which bears the same ratio to—

"(A) the net investment income, as

"(B) the amount of such reserves bears to the mean (as of the beginning and end of the taxable year) of the book value of all the assets, other than real property occupied by the insurance company and furniture, fixtures, and equipment (to the extent such real or personal property is used in carrying on the insurance business).

"(2) PENSION PLAN RESERVES DEFINED.—For purposes of this section, the term 'pension plan reserves' means that portion of the qualified reserves (other than items described in paragraph (2), (4), (5), or (6) of subsection (d)) which is allocable to contracts—

"(A) purchased under contracts entered into with trusts which (as of the time the contracts were entered into) were deemed to be (i) trusts described in section 401 (a) and exempt from tax under section 501 (a), or (ii) trusts exempt from tax under section 165 of the Internal Revenue Code of 1939 or the corresponding provisions of prior revenue laws;

"(B) purchased under contracts entered into under plans which (as of the time the contracts were entered into) were deemed to be plans meeting the requirements of section 401 (a) (3), (4), (5), and (6), or the requirements of section 165 (a) (3), (4), (5), and (6) of the Internal Revenue Code of 1939; or

"(C) provided for employees of the life insurance company under a plan which, for the taxable year, meets the requirements of section 401 (a) (3), (4), (5), and (6).

"(f) NET INVESTMENT INCOME ALLOCABLE TO RESERVES FOR ANNUITY CONTRACTS AND DEPOSITS.—

"(1) ALLOCATION RATIO.—For purposes of this subpart, the amount of the net investment income allocable to reserves for annuity contracts and deposits is that amount which bears the same ratio to the net investment income as such reserves bear to the qualified reserves (as defined in subsection (d)).

"(2) RESERVES FOR ANNUITY CONTRACTS AND DEPOSITS.—

"(A) IN GENERAL.—For purposes of this subpart, the amount of the reserves for annuity contracts and deposits is the sum of the following:

"(i) that portion of the qualified reserves which is allocable to annuity contracts; and

"(ii) the amounts described in subsection (d) (5).

"(B) CERTAIN ITEMS EXCLUDED.—Any item which (but for this subparagraph) would be within the application of subparagraph (A) shall be excluded from such application—

"(i) if it is allocable to a pension plan reserve,

"(ii) if it is an amount described in paragraph (2), (4), or (6) of subsection (d), or

"(iii) if it is allocable to a contract entered into before July 1, 1955, or to a contract the terms of which are dependent on terms of a contract entered into before July 1, 1955. This clause shall not apply if (as of July 1, 1955) such contract (or the predecessor contract in effect on such date) provided for participation in surplus earnings of the insurance company.

"(3) ANNUITY CONTRACT DEFINED.—For purposes of paragraph (2) (A) (i), the term 'annuity contract' means any agreement (whether arising under a life insurance, annuity, or endowment contract, or a contract supplementary thereto) if (as of the time the computation is being made under this subsection)—

"(A) such agreement provides for payments in installments and during the life of one or more annuitants or for a period certain;

"(B) in case any amount (other than dividends) is payable other than as described in subparagraph (A), the value of such amount, computed as of the earliest time when such amount (or any portion thereof) may become payable, cannot exceed the excess of (i) the sum of the consideration theretofore paid for such agreement (or the amount otherwise invested in such agreement) plus accrued interest, over (ii) the aggregate of the amounts (other than dividends) theretofore received under such agreements; and

"(C) in the case of an agreement arising under a life insurance or endowment contract, or a contract supplementary thereto, payments described in subparagraph (A) have become due and payable under such agreement.

(g) NET INVESTMENT INCOME ALLOCABLE TO NON-LIFE INSURANCE RESERVES.—

"(1) ALLOCATION RATIO.—For purposes of this subpart, the net investment income allocable to non-life insurance reserves is that amount which bears the same ratio to the net investment income as such reserves bear to the qualified reserves.

"(2) NON-LIFE INSURANCE RESERVES DEFINED.—For purposes of this subpart, the term 'non-life insurance reserves' means the sum of the unearned premiums and the unpaid losses (whether or not ascertained)—

"(A) on contracts other than life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance), and

"(B) which are not included in life insurance reserves (as defined in section 801 (b)).

For purposes of this paragraph, such unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such other contracts.

"(3) ADJUSTMENTS WITH RESPECT TO CERTAIN NON-LIFE INSURANCE CONTRACTS.—For purposes of this subpart, if—

"(A) any computation under this subpart is made by reference to a contract meeting the requirements of paragraph (2) (A) of this subsection, and

"(B) part of the reserves for such contract are life insurance reserves, then, under regulations prescribed by the Secretary or his delegate, proper adjustment shall be made in the amount taken into account with respect to such contract for purposes of such computation.

"SEC. 805. SPECIAL INTEREST DEDUCTION.

"(a) SPECIAL INTEREST DEDUCTION.—For purposes of the tax imposed by section 802 (and the tax imposed by section 811), there shall be allowed a special interest deduction determined as follows:

"(1) Divide the amount of the adjusted net investment income (as defined in subsection (b)) by the amount of the required interest (as defined in subsection (c)).

"(2) If the quotient obtained in paragraph (1) is 1.05 or more, the special interest deduction shall be zero.

"(3) If the quotient obtained in paragraph (1) is 1.00 or less, the special interest deduction shall be an amount equal to 50 percent of the amount by which—

"(A) the net investment income (reduced by the net investment income allocable to non-life insurance reserves), exceeds

"(B) the reserve and other policy liability deduction for the taxable year.

"(4) If the quotient obtained in paragraph (1) is more than 1.00 but less than 1.05, the special interest deduction shall be the amount obtained by multiplying—

"(A) the amount by which (i) the net investment income (reduced by the net investment income allocable to non-life insurance reserves) exceeds (ii) the reserve and other policy liability deduction for the taxable year, by

"(B) 10 times the difference between the figure 1.05 and the quotient obtained in paragraph (1).

"(b) ADJUSTED NET INVESTMENT INCOME.—For purposes of subsection (a) (1), the term 'adjusted net investment income' means—

"(1) the net investment income (computed without the deduction for wholly-exempt interest allowed by section 803 (c) (1)), minus

"(2) 50 percent of the net investment income allocable to non-life insurance reserves.

"(c) REQUIRED INTEREST.—For purposes of subsection (a) (1), the term 'required interest' means the total of—

"(1) the sum of the amounts obtained by multiplying—

"(A) each rate of interest assumed in computing the taxpayer's life insurance reserves, by

"(B) the means of the amounts of the taxpayer's life insurance reserves computed at such rate at the beginning and end of the taxable year, plus 7 percent of the portion of such reserves at such rate as are computed on a preliminary term basis;

"(2) the sum of the amounts obtained by multiplying—

"(A) each rate of interest assumed in computing the taxpayer's reserves for deferred dividends described in section 804 (d) (4), by

"(B) the means of the amounts of such reserves computed at such rate at the end of the taxable year; and

"(3) interest paid.

"(d) INTEREST PAID.—For purposes of subsection (c) (3), the term 'interest paid' means—

"(1) all interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this chapter; and

"(2) all amounts in the nature of interest, whether or not guaranteed, paid or accrued within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time of payment or accrual, life, health, or accident contingencies.

"Subpart B—1942 Formula

"Sec. 811. Tax imposed.
"Sec. 812. Reserve and other policy liability deduction.
"Sec. 813. Adjustment for certain reserves.

"SEC. 811. TAX IMPOSED.

"(a) TAX IMPOSED.—A tax is hereby imposed, on the life insurance company taxable income of every life insurance company, for each taxable year beginning after December 31, 1955 (other than taxable years with respect to which a tax is imposed by section 802). Such tax shall consist of—

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

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

"(b) LIFE INSURANCE COMPANY TAXABLE INCOME DEFINED.—For purposes of this subpart, the term "life insurance company taxable income' means the net investment income (as defined in section 803 (c))—

"(1) minus the reserve and other policy liability deduction allowed by section 812,

"(2) minus the special interest deduction, if any, allowed by section 805, and

"(3) plus the amount of the adjustment for certain reserves provided in section 813.

For purposes of the normal tax, the life insurance company taxable income shall be reduced by the deduction provided in section 242 for partially tax-exempt interest.

"(c) RULE FOR COMPUTATION OF SPECIAL INTEREST DEDUCTION.—In computing the special interest deduction under section 805 in the case of any taxable year with respect to which a tax is imposed under this section, in lieu of the reduction for the net investment income allocable to non-life insurance reserves provided in paragraphs (3) (A) and (4) (A) of section 805 (a), and in paragraph (2) of section 805 (b), the net investment income shall be reduced by an amount which equals the amount of the adjustment for certain reserves provided in section 813.

"SEC. 812. RESERVE AND OTHER POLICY LIABILITY DEDUCTION.

"(a) GENERAL RULE.—For purposes of this subpart, the term 'reserve and other policy liability deduction' means an amount computed by multiplying the net investment income by a figure, to be determined and proclaimed by the Secretary or his delegate for each taxable year with respect to which a tax is imposed by section 811. This figure shall be based on such data with respect to life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative and shall be computed in accordance with the following formula: The ratio which a numerator comprised of the aggregate of the sums of—

"(1) 2 percent of the reserves for deferred dividends,

"(2) interest paid, and

"(3) the product of—

"(A) the mean of the adjusted reserves at the beginning and end of the taxable year, and

"(B) the reserve earnings rate,

bears to a denominator comprised of the aggregate of the excess of net investment incomes (computed without the deduction for wholly-exempt interest allowed by section 803 (c) (1)) over the adjustment for certain reserves provided in section 813.

"(b) DEFINITIONS.—For purposes of subsection (a)—

"(1) RESERVES FOR DEFERRED DIVIDENDS.—The term 'reserves for deferred dividends' has the same meaning as when used in section 804 (d) (4).

"(2) INTEREST PAID.—The term 'interest paid' has the meaning given to such term by section 805 (d).

"(3) ADJUSTED RESERVES.—The term 'adjusted reserves' means the life insurance reserves (as defined in section 801 (b)), plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

"(4) RESERVE EARNINGS RATE.—The term 'reserve earnings rate' means a rate computed by adding 2.1125 percent (65 percent of 3¼ percent) to 35 percent of the average rate of interest assumed in computing life insurance reserves. Such average rate shall be calculated by multiplying each assumed rate of interest by the means of the amounts of the adjusted reserves computed at that rate at the beginning and end of the taxable year and dividing the sum of the products by the mean of the total adjusted reserves at the beginning and end of the taxable year.

"(c) MAXIMUM DEDUCTION.—The reserve and other policy liability deduction allowed by subsection (a) of this section shall in no case exceed an amount equal

to the amount which would be determined under subsection (c) of section 804 if such subsection applied with respect to the taxable year.

"SEC. 813. ADJUSTMENT FOR CERTAIN RESERVES.

"In the case of a life insurance company writing contracts other than life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance), the term 'adjustment for certain reserves' means, for purposes of this subpart, an amount equal to 3¼ percent of the unearned premiums and unpaid losses on such other contracts which are not included in life insurance reserves (as defined in section 801 (b)). For purposes of this section, such unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such other contracts.

"Subpart C—Miscellaneous Provisions

"Sec. 816. Foreign life insurance companies.
"Sec. 817. Denial of double deductions.
"Sec. 818. Certain new insurance companies.

"SEC. 816. FOREIGN LIFE INSURANCE COMPANIES.

"(a) CARRYING ON UNITED STATES INSURANCE BUSINESS.—A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 801, shall be taxable in the same manner as a domestic life insurance company; except that the determinations necessary for purposes of this subtitle shall be made on the basis of the income, disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Insurance Commissioners.

"(b) NO UNITED STATES INSURANCE BUSINESS.—Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this part but shall be taxable as other foreign corporations.

"SEC. 817. DENIAL OF DOUBLE DEDUCTIONS.

"Nothing in this part shall permit the same item to be deducted more than once.

"SEC. 818. CERTAIN NEW INSURANCE COMPANIES.

"(a) GENERAL RULE.—If the taxpayer was authorized to do business in any State or Territory as an insurance company before July 1, 1955, and if the taxable year begins not more than 4 years after the first day on which the taxpayer was authorized to do such business, then—

"(1) for purposes of subpart A, the life insurance taxable income shall not exceed (A) the amount of the net gain from operations after dividends to policyholders, reduced by (B) the net investment income allocable to non-life insurance reserves; or

"(2) for purposes of subpart B, the life insurance company taxable income shall not exceed the amount of the net gain from operations after dividends to policyholders.

For purposes of this subjection, the net gain from operations after dividends to policyholders shall be computed in the manner required for purposes of the annual statement approved by the National Convention of Insurance Commissioners, except that no reduction shall be made for any Federal income tax.

"(b) LIMITATION.—This section shall not reduce the tax for any taxable year below the amount which (but for this section) would be imposed by section 802 or section 811, as the case may be, computed without the applicable limitation on the reserve and other policy liability deduction contained in section 804 (c) or section 812 (c).

"(c) SPECIAL RULE FOR ADDITIONAL DIVIDENDS RECEIVED DEDUCTION.—If the taxpayer's tax for the taxable year is reduced by subsection (a), and if the limitation contained in subsection (b) does not apply, then the maximum limitation referred to in section 804 (c) (3) (B) (ii) shall be—

"(1) in the case of a taxable year with respect to which tax is imposed by section 802, the amount by which (A) the net investment income (reduced by the net investment income allocable to non-life insurance reserves), exceeds (B) the life insurance taxable income; or

"(2) in the case of a taxable year with respect to which tax is imposed by section 811, the amount by which (A) the sum of the net investment income and the amount of the adjustment for certain reserves provided in section 813, exceeds (B) the life insurance company taxable income."

SEC. 3. ADJUSTMENTS TO INVESTMENT INCOME OF INSURANCE COMPANIES OTHER THAN LIFE.

(a) MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE).—The following provisions of part II of subchapter L of chapter 1 of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Paragraph (2) of section 821 (a) is amended by striking out "interest, dividends, rents," and inserting in lieu thereof "the items described in section 822 (b) (other than paragraph (1) (D) thereof)".

(2) Section 821 (c) is amended by striking out "interest, dividends, rents," and inserting in lieu thereof "the items described in section 822 (b) (other than paragraph (1) (D) thereof)".

(3) Section 822 (b) is amended to read as follows:

"(b) GROSS INVESTMENT INCOME.—For purposes of subsection (a), the term 'gross investment income' means the sum of the following:

"(1) The gross amount of income during the taxable year from—

"(A) interest, dividends, rents, and royalties,

"(B) the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,

"(C) the alteration or termination of any instrument or agreement described in subparagraph (B), and

"(D) gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).

"(2) The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1)."

(4) Paragraph (3) of section 822 (c) is amended to read as follows:

"(3) REAL ESTATE EXPENSES.—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property."

(5) Paragraph (6) of section 822 (c) is amended by striking out "the sum of interest, dividends, rents, and net premiums received. In the application of section 1211" and inserting in lieu thereof "the sum of the items described in subsection (b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212".

(6) Section 822 (c) is amended by adding at the end thereof the following new paragraphs:

"(8) TRADE OR BUSINESS DEDUCTIONS.—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

"(A) any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

"(B) the deduction for net operating losses provided in section 172 shall not be allowed.

"(9) DEPLETION.—The deduction allowed by section 611 (relating to depletion)."

(7) Section 822 (d) (1) is amended by striking out "subsection (e) (3) or (4)" and inserting in lieu thereof "subsection (c) (3) or (4)".

(8) Section 822 (e) is amended by striking out "interest, dividends, rents," and inserting in lieu thereof "items described in subsection (b) (other than paragraph (1) (D) thereof)".

(b) STOCK COMPANIES (OTHER THAN LIFE).—The following provisions of section 832 are hereby amended as follows:

(1) Paragraph (4) of subsection (b) is amended by striking out "section 806" and inserting "section 801 (b)".

(2) Paragraph (5) of subsection (c) is amended by striking out "interest, dividends, rents, and net premiums received. In the application of section 1211" and inserting in lieu thereof "the items described in section 822 (b)

(other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212".

(3) Paragraph (8) of subsection (c) is amended by inserting after "section 167" the following: "and the deduction allowed by section 611 (relating to depletion)".

SEC. 4. ANNUAL ACCOUNTING PERIOD OF INSURANCE COMPANIES TO BE THE CALENDAR YEAR.

(a) Part IV of subchapter L of chapter 1 of the Internal Revenue Code of 1954 (relating to provisions of general application with respect to insurance companies) is hereby amended by adding at the end thereof the following new section:

"SEC. 843. ANNUAL ACCOUNTING PERIOD.

"For purposes of this subtitle, the annual accounting period for each insurance company subject to a tax imposed by this subchapter shall be the calendar year."

(b) The table of sections for such part IV is hereby amended by adding at the end thereof the following:

"Sec. 843. Annual accounting period."

SEC. 5. TECHNICAL AMENDMENTS.

The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Section 316 (b) (1) (relating to definition of dividends) is amended to read as follows:

"(1) CERTAIN INSURANCE COMPANY DIVIDENDS.—The definition in subsection (a) shall not apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such."

(2) Section 501 (c) (15) (relating to certain exempt mutual insurance companies) is amended by striking out "interest, dividends, rents," and inserting in lieu thereof "the items described in section 822 (b) (other than paragraph (1) (D) thereof)".

(3) Section 594 (a) (2) is amended by striking out "the taxable income (as defined in section 803)" and inserting in lieu thereof "the income".

(4) The first sentence of section 841 (relating to credit for foreign taxes) is amended by inserting "811," after "802,". Paragraph (1) of the second sentence of such section is amended to read as follows:

"(1) in the case of the tax imposed by section 802 or 811, the net investment income (as defined in section 803 (c)),".

(5) Section 842 (relating to computation of gross income) is amended by striking out "802 or 831" and inserting in lieu thereof "802, 811, or 831".

(6) Section 891 (relating to doubling of rates of tax in case of discrimination by a foreign country) is amended by inserting "811," after "802,".

(7) Section 1201 (a) (relating to alternative tax on capital gains) is amended by inserting "802 (a)," after "511,".

(8) Section 1504 (b) (2) (relating to exceptions from consolidated return provisions) is amended by striking out "802 or 831" and inserting in lieu thereof "802, 811, or 821".

(9) Paragraph (2) of section 4371 (relating to tax on policies issued by foreign insurers) is amended by striking out "807" ind inserting in lieu thereof "816".

SEC. 6. EFFECTIVE DATE.

The amendments made by this Act shall apply only to taxable years beginning after December 31, 1954.

Passed the House of Representatives July 18, 1955.

Attest: RALPH R. ROBERTS, *Clerk.*

The CHAIRMAN. At the request of Senator Millikin, I desire to insert in the record a letter written to me by the Capitol Life Insurance Co., Denver, Colo.

(The letter dated July 25, 1955, is as follows:)

THE CAPITOL LIFE INSURANCE CO.,
Denver, Colo., July 25, 1955.

Re H. R. 7201—Taxation of Life-Insurance Companies—Special Small Company Credit.

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

DEAR SIR: It is recognized with unanimity by all segments of the life-insurance industry that the smaller companies within it are entitled to special treatment on income taxation because of peculiarities of the business. That the business is different is reflected by the unique treatment taxwise of the industry as a whole for many years.

To reflect this, the industry has strongly recommended that the special small company credit be included in this year's legislation, but it is not in the subject bill as passed by the House of Representatives.

It is urged that the special small company credit be included in the bill for the following reasons:

1. As a whole, the smaller companies tend to have a higher guaranteed rate on their liabilities (reserves), and hence have a smaller margin between investment income and interest guaranties. As the bill is now written, it accordingly has a relatively heavier impact taxwise on the smaller companies than on the larger. The suggested credit would broadly offset this disadvantage under which the smaller companies are placed.
2. It is estimated that tax revenues would be reduced by $1,500,000 by this credit, and even with it, this present bill substantially increases, by its other provisions, income-tax revenue to the Treasury from the life-insurance industry.
3. The section provides that only the smallest companies will receive the full credit, and as they grow, the credit is reduced. Further, it is so drawn that it is not possible for any but smaller companies to take advantage of it.

Although the number of companies subject to the credit is relatively substantial, they, all together, are a very minor part of the life-insurance industry. A study of 1953 figures indicates that, had this credit been in effect that year, companies paying more than 95 percent of total taxes would not have been affected. Considering the increased effective rate in the present bill and normal growth over a 2-year period, it may be assumed that those paying an even higher percent of total taxes would not be affected this year.

4. No precedent will be created for other elements of the economy, as it has been traditionally recognized that the life-insurance industry is unique and treated accordingly.

Respectfully yours,

MELVIN J. ROBERTS, *Treasurer.*

The CHAIRMAN. At the request of Senator Lyndon Johnson, I desire to insert in the record at this point a letter written by Sneed & Vine, a law firm of Austin, Tex., making several suggestions.

(The letter dated July 23, 1955, is as follows:)

AUSTIN, TEX., *July 23, 1955.*

Re H. R. 7201, 84th Congress, 1st session.

Hon. LYNDON B. JOHNSON,
United States Senator,
Senate Office Building, Washington, D. C.

DEAR SENATOR JOHNSON: I have had the privilege of discussing with Mr. Perry and Mr. Jenkins of your office the problems of the mutual assessment life-insurance industry over the above-captioned bill. The enclosed statement attempts to cover the problem in detail. Similar statements have been furnished at her request to Mrs. Elizabeth Springer, clerk of the Finance Committee.

We believe that the tax problem as explained in the statement is purely an oversight and certainly not the intention of the bill to tax in toto the investment income arising from investment of the reserve funds of Texas mutual assessment life-insurance companies, although this is the effect of the bill as to be heard before the Finance Committee on July 25.

The statement contains an amendment which we believe will solve the problem and at the same time it contains a ceiling of a 4-percent return so as to prohibit any possible loophole.

Your help in obtaining the adoption of this or a similar amendment will be greatly appreciated. Would you please call me collect at 88516 in Austin should there be any developments in this matter.

It is wonderful news to know of your speedy recovery and Dad and our entire family hope that you will soon be able to return to Texas for a long overdue rest.

With best wishes and kindest personal regards, I remain

Yours very truly,

SNEED & VINE,
By ROBERT C. SNEED.

STATEMENT OF ROBERT C. SNEED, AUSTIN, TEX.

My name is Robert C. Sneed, an attorney of Austin, Tex., and I represent the Texas Association of Mutual Life Insurance Officials, a trade organization composed of managing officers of mutual assessment life-insurance companies regulated by the Board of Insurance Commissioners of the State of Texas. Approximately two and one-half million persons are insured by Texas mutual assessment companies.

The particular problem of these companies with regard to H. R. 7201 is limited to the one question of whether or not the investment income from the reserve funds (called mortuary or relief funds under the Texas law) is such as to be within the definition of "required interest" as defined in section 805 (c) (3).

In connection with the above query, the following statements are made as to such companies:

(1) At least 60 percent of all assessments or premium income, exclusive of membership fees, of such companies must be placed in the mortuary or relief fund of the company and from which fund claims are paid.

(2) The other portion of the assessment or premium is placed in a fund called expense fund and from which all expenses are paid.

(3) The mortuary or relief fund belongs exclusively to the policyholders, and in the event of dissolution of the company, all assets therein would be distributed to the policyholders, based upon their interest in the fund by reason of the amounts thereto paid.

(4) Under Texas law, the mortuary or relief funds of such companies may only be invested in such securities as are legal investments for reserve funds of stock life-insurance companies.

(5) Under Texas law, mutual assessment companies issue life policies only withour cash surrender or loan values.

(6) The mortuary or relief funds of these companies comply with the life insurance reserves definition contained in section 801 (b) (3) of H. R. 7201.

(7) There is no interest rate actuarially assumed under the terms of these policies, although such investment income enables policies to be issued at a lower rate and reduces the number of assessments. All investment income of mortuary or relief funds must be placed in such fund for the exclusive benefit of the policyholders.

(8) Texas mutual assessment companies have no capital or surplus funds.

By reason of the foregoing it appears that the definition of required interest in section 805 (c) would not include the investment income of the mortuary or relief funds of these companies, and thereby this investment income from funds designated elsewhere in the bill as life insurance reserves would be taxed as ordinary corporate income in the entirety.

It would therefore seem that inadvertently a tax would be levied upon the investment income of the policyholders' reserves of mutual assessment companies. This would not appear to be intended from an overall reading of the bill, as this tax does not so apply to any other type of life-insurance company.

Based upon such problem, the following amendment to H. R. 7201 is respectfully suggested, by inserting the following wording after section 805 (c) (3) at page 26 after line 4:

"(4) In the case of an assessment life insurance company or association the term 'required interest' is the amount of investment income on life insurance reserves as defined in section 801 (b) (3) which does not exceed 4 per centum of said life insurance reserves."

Your consideration of the merits of this problem is sincerely requested.

Senator CARLSON. May I place in the record a wire I have received from M. J. C. Higdon, president of the Business Men's Assurance Co., of Kansas City, Mo.

The CHAIRMAN. Without objection, that will be inserted in the record.

(The telegram dated July 20, 1955, is as follows:)

KANSAS CITY, MO., *July 20, 1955.*

Senator FRANK R. CARLSON,
Washington, D. C.:

The late W. T. Grant, chairman and founder of Business Men's Assurance Co., had for many years worked with a life-insurance industry committee which conferred with the Treasury Department and Members of Congress of the United States in developing tax legislation applicable to the industry. I believe that at various times he had discussed the subject with you in Washington and Kansas City. Prior to his death he was active in preliminary work which has resulted in development of the Mills bill, H. R. 7201, which is currently under consideration by the Senate Finance Committee. From the standpoint of the industry this bill places the Federal tax burden on the various insurance companies more equitably and more nearly in accordance with their ability to pay than any previous bills. Since it results in an increase of total revenue in an amount which is acceptable to the Government, we urge that you do all in your power to expedite the favorable consideration of this bill by the Senate Finance Committee in order that it may be passed in this session of Congress.

J. C. HIGDON,
President, Business Men's Assurance Co.

The CHAIRMAN. Our first witness this morning is Mr. Laurens Williams, assistant to the Secretary of the Treasury.

Senator KERR. Are there any copies of Mr. Williams' statement available?

STATEMENT OF LAURENS WILLIAMS, ASSISTANT TO THE SECRETARY OF THE TREASURY; ACCOMPANIED BY RAYMOND CONKLING, LEGAL ADVISORY STAFF, AND RICHARD E. SLITOR, TAX ANALYSIS STAFF, TREASURY DEPARTMENT

Mr. WILLIAMS. Mr. Chairman and gentlemen of the committee, I do not have a prepared statement. I have given to the clerk for distribution copies of the two letters from the Secretary to the Chairman of the Ways and Means Committee which I shall read and which constitute in effect my statement, sir.

I assume that has been distributed to you.

The Secretary is out of the city and has asked me to appear on his behalf, to present to you the views of the Treasury Department on the matter before you.

The Treasury Department had been studying this problem over an extended period of time. We had worked rather closely with the staff of the Joint Committee on Internal Revenue, had conferences with representatives of the industry, and as the bill pending before you now was developed, we originally believed that we should oppose its enactment.

However, after the bill was limited to 1 year only, it was concluded that we should not oppose it, and we now have withdrawn our objections to it.

Our position is well stated, I believe, in the letter to the Chairman of the Ways and Means Committee, which the Secretary of the Treasury wrote under date of July 7, 1955. That letter is as follows:

Hon. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: I attach a copy of the letter which we originally had intended to send to you on the proposed bill on taxation of life insurance com-

panies. Since the letter was prepared, the bill has been limited to 1 year only and I have discussed it with Mr. Mills and Mr. Curtis who assure me of their concurrence with our view that the whole problem should have further study, and that further legislation should be developed for enactment next year.

Since the bill contains substantial improvements over the law in effect last year and since the suggestions embodied in the attached letter will have your careful study in connection with next year's legislation, we withdraw our objection to H. R. 7201 and approve its enactment.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

The letter which was attached to that letter and went to the Chairman of the Ways and Means Committee with it is as follows:

Hon. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: I regret that the Treasury Department cannot unqualifiedly endorse H. R. 7201, which provides a new method for the taxation of life insurance companies, even though it will be effective only for the years 1955 and 1956.

The bill would make desirable improvements in the definition of income. It would limit abuses by investment companies which do a small amount of insurance business, and by certain casualty companies which inflate their life insurance business by means of policy loans, to qualify for favorable tax treatment. The bill would be fairer than the present law because it would treat the group annuity business of the life insurance companies more like tax-exempt qualified pension trusts with which they compete. It also properly would eliminate duplication of the 85 percent intercorporate dividend credit and the proposed 85 and other percentage credits for reserve and other policy interest. The proposed segregation and separate taxation of their cancellable health and accident business, on a basis comparable to mutual fire and casulty companies in the same line of business, seems sound, though the wisdom of not taxing substantial amounts of the profits of some of the companies should have further study.

However, the proposed exclusion from the tax base of a flat 85 percent of investment income for ordinary life-insurance business does not appear to be justified. The resulting tax currently seems inadequate.

Our estimates indicate that, on the basis of present earnings and contracts with policyholders, the life-insurance companies will need only slightly over 75 percent of their 1955 investment income to meet their required reserve and policy interest, as compared with the 85 percent allowance in the bill. On these facts, it does not seem fair to the Government to adopt a formula which will permit the companies to go untaxed on investment income which is not needed under their contracts with their own policyholders. The total annual investment income of life-insurance companies now exceeds $3 billion. The corporate tax on almost 10 percent of that total is a very large sum.

Since 1921, life-insurance companies have been taxed only on their free investment income, that is, their investment income in excess of the amounts they were committed or required to set aside as reserves under their policy contracts. Their income from other sources has gone untaxed.

The 1942 law assumed that the companies would be required to earn 3¼ percent on a major part of their investments to meet their policy requirements, and determined their taxable free investment income on that assumption. As the companies wrote policies on the basis of lower interest rates, this high assumption of required earnings was so unrealistic that the companies would not have been required to pay any tax at all for several years, even though they actually had very substantial investment income over their contractual needs.

In 1950 a taxing method was adopted under which the tax was based on the actual free investment income for each year. Though probably not ideal (other income continued untaxed; the individual companies were taxed on an industry average of their investment income), this method at least provided a logical basis for taxation. The life-insurance industry accepted this method, and even urged its adoption on a long-range basis.

In 1951 the policy requirements were about 87½ percent of actual earnings, which left a free investment income of 12½ percent. The 52-percent corporate tax on 12½ percent of earnings was about equal to 6½ percent on the entire invest-

ment income. A 6½-percent tax was imposed on all investment income, and was successively extended through 1954. This taxing method had no logical basis of its own, other than as a short-cut method of computation.

In the years since 1951 the companies' actual free investment income has increased steadily. It is estimated that for 1955 they need only 75.5 percent of their investment income to meet their policy requirements If determined in the same way as was done in 1951, the comparable tax rate on all investment income would have to be almost doubled (increased to 12.7 percent) in 1955.

The Treasury Department has reviewed carefully the history and problems of taxation of life insurance companies. The valuable material in the hearings and the staff studies of the subcommittee of the Ways and Means Committee, published last year and earlier this year, has been examined. On the basis of our review and examination, I suggest that an attempt be made to develop a method of taxing life insurance companies like other business, on the basis of their entire income from all sources, with appropriate deductions for their expenses and additions to their reserves against their policy contracts. The reliance on free investment income alone ignores income and losses from mortality experience, the relation between loading charges and operating costs, and capital gains—which may be quite substantial.

Life insurance companies were taxed like other corporations on the basis of their entire net income until 1921, when the tax base was confined to free investment income. At that time, income taxation was still so new and undeveloped that it was found to be extremely difficult to deal adequately with the specialized problems of the life insurance industry. Substantial advances have been made since that time in tax administration, and the methods and techniques of income measurement. It should now be possible to develop a fairer basis for taxation which will include all of the income and deduction items which properly reflect the earnings position of a life insurance company.

The development of a satisfactory formula for taxing insurance companies on a comprehensive concept of income will take time. In the meantime, the 1950 formula (taxation of actual free investment income) gives a logical standard for measuring free investment income and the industries' capacity to pay. We estimate that this formula for taxing insurance companies would produce revenue of $368 million for this year, as against $189 million under the 6½ percent rate in effect from 1951 through 1954, and $215 million under H. R. 7201. In the absence of any legislation this year, the 1942 formula will become applicable again and produce revenue estimated at $274 million, as compared to $215 million under H. R. 7201 and $368 million under the 1950 formula.

The Treasury is impressed with the need for a fair and sound approach to the taxation of life-insurance companies. A satisfactory solution must recognize the special situation of the life-insurance industry and its responsibilities to policyholders. At the same time, it should impose a tax which is fairly distributed among the companies and fair in relation to the tax burdens of other savings institutions and taxpayers generally.

I and the Treasury Department staffs will be glad to be of such assistance as we can to your committee and staffs in any further examination of this subject which you choose to undertake.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

Following transmission of that letter, the bill, as you know, was reported out by the Ways and Means Committee. In their report, the Ways and Means Committee said, among other things——

Senator MARTIN. What is the date of the Secretary's letter?

Mr. WILLIAMS. July 7.

Senator MARTIN. The other is the same date then?

Mr. WILLIAMS. The long letter which I have just completed reading was prepared for transmission without date. Subsequently, before it was transmitted, the Secretary had conferences with Mr. Mills and Mr. Curtis——

Senator MARTIN. That is perfectly all right. I just wanted to get the date. There was no date on it.

The CHAIRMAN. Were any amendments offered to the bill, whereby the Secretary changed his mind, except the fact that it was limited to 1 year only?

Mr. WILLIAMS. No, sir. It was the change from 2 years to 1 year, plus the assurance of members of the Ways and Means Committee that the recommendations and suggestions of the Secretary embodied in the long letter I have just read, would have the careful study of the Ways and Means Committee in connection with developing legislation for next year.

The CHAIRMAN. The changes recommended by the Secretary in the long letter, none of them were adopted?

Mr. WILLIAMS. They have not been adopted.

The CHAIRMAN. Proceed to complete your statement, sir.

Mr. WILLIAMS. I have substantially explained what I was about to explain. So I think that completes my statement. If there are any questions, I will be glad to answer them.

The CHAIRMAN. Thank you very much.

Are there any questions?

Senator KERR. Yes, sir, Mr. Chairman. I want to congratulate the Treasury on the contents of the memorandum which was attached to the letter.

Mr. WILLIAMS. Thank you, sir.

Senator KERR. I think it is the clearest presentation that has ever been made to this committee in my knowledge of the specifications of tax exemption, of which the insurance companies as of now, and for some years past, are, and have been, the beneficiaries.

Mr. Williams, the Treasury originally objected rather strenuously to H. R. 7201?

Mr. WILLIAMS. Yes, sir.

Senator KERR. As I understand this memorandum, their objections went far beyond just the term of the applicability of the bill.

Senator BARKLEY. By the "memorandum" do you mean the long letter?

Senator KERR. That is correct.

The one he has just read.

Mr. WILLIAMS. That is correct, sir. With one perhaps minor addition. As originally proposed, this bill was proposed as a permanent solution of the problem. And it was basically to the concept that this was a permanent solution that the Treasury objected. When the concept that H. R. 7201 was a permanent solution to the problem was eliminated, and the matter put on simply a 1-year proposition, we immediately withdrew our objection because of the very practical point that this bill does represent, in our view, substantial improvement over either (*a*) the 1942 law, which automatically would come into play in the absence of legislation this year; or (*b*) the so-called stop-gap formular that has been applied since 1951.

It is a better bill, in our opinion, in many respects than either of those two prior laws.

Senator KERR. According to your own statement, H. R. 7201 would produce $215 million revenue and the 1942 formula would produce $274 million?

Mr. WILLIAMS. That is correct, but we have not viewed this solely as a problem of how much revenue is raised.

Senator KERR. That is not an inconsequential item, is it?

Mr. WILLIAMS. It is important, sir; yes sir.

Senator KERR. Now, is it not a fact that H. R. 7201 violates some of the objections you have in this memorandum even more violently than the present law?

Mr. WILLIAMS. No, I think not, sir.

Senator KERR. As I understand it, your statement is that H. R. 7201 would produce $26 million more than a continuation of the present law?

Mr. WILLIAMS. Yes, sir.

Senator KERR. While that is true, is it not also true that a very large number of the larger insurance companies would pay less under H. R. 7201 than they would under a continuation of the present law?

Mr. WILLIAMS. I am so advised; yes, sir.

Senator KERR. And is it not a fact that generally the smaller insurance companies would not only have to make up that deficit but also the principal part of the additional $26 million?

Mr. WILLIAMS. I will ask Mr. Slitor to confirm my statement. I have the impression that that is at least in part true, sir; that this bill will transfer to some extent the burden of the tax from some companies which do a substantial amount of pension business.

Senator KERR. Some of the larger companies?

Mr. WILLIAMS. Yes.

Senator KERR. Some of the largest companies?

Mr. WILLIAMS. Yes, sir.

Senator KERR. Well, now, are you prepared to tell this committee that there is virtue in a situation of that kind?

Mr. WILLIAMS. You understand, we have not recommended this bill as a perfect solution. On the contrary, we have simply withdrawn our previous objections to it because, since there is not time to develop the type of overall taxing method which we believe is the proper method. We, therefore, must have one of three things. I assume it is a practical problem, sir. We either have the 1942 formula come back into operation, reenact something along the line of last year's measure, or have something along the line of this bill, choosing among the latter three alternatives.

Senator KERR. You only named two.

Mr. WILLIAMS. The 1942 method, the 1951 method, the method of H. R. 7201.

Senator KERR. Why not add a fourth, that is language to implement the principles of the 1951 bill, because you have certainly in this statement laid the predicate for such a fourth alternative. Did you not?

Mr. WILLIAMS. I think not.

Senator KERR. Did you not say here——

Mr. WILLIAMS. The 1950 bill.

Senator KERR. Did you not say here the 1950 bill was to capture half of the free investment income or 52 percent of the free investment income?

Mr. WILLIAMS. Yes. The principle of that measure, as I understand it, is that it would apply the regular corporate tax on the actual free investment income.

Senator KERR. Is not that another way of saying what I have just said?

Mr. WILLIAMS. Yes.

Senator KERR. Does not this proposal of yours at least have the germ of a fourth alternative, which would be a bill to capture half or 52 percent of the free investment income for this 1 year?

Mr. WILLIAMS. In substance, yes, sir.

Senator KERR. And on the basis of the recommendations of the Treasury, would not the bill doing that be far more acceptable to the Treasury than H. R. 7201?

Mr. WILLIAMS. I believe it would, sir. Yes, sir.

Senator KERR. If such a bill were written, which would capture half of the free investment income in the year of applicability of the proposed bill, I believe, according to your own statement here, it would still leave untaxed very substantial portions of the actual profits of the insurance companies. Where in this statement did you outline those elements of income which are not presently being taxed?

Mr. WILLIAMS. I think you will find those on the top of page 3, the first full sentence.

Senator KERR. Yes. [Reading:]

> The reliance on free investment income alone ignores income and losses from mortality experience, the relation between loading charges and operating costs; and capital gains—which may be quite substantial.

Mr. WILLIAMS. Yes, sir.

Senator KERR. So that if the Congress actually passed a bill applying the principle of the 1950 act, that is, to capture half of the free investment income, it would do these two things on the basis of your recommendation: No. 1, it would produce $368 million in revenue instead of $215 million or $241 million. And, No. 2, it would impose no greater burden on the insurance program with reference to their free investment income alone than is now being borne by all other taxpaying corporations, or taxpayers.

And next it would still leave exempt from taxation income from mortality experience, the relation between loading charge and operating costs, and capital gains, which are quite substantial.

Mr. WILLIAMS. I think that is correct, sir.

Senator KERR. Then would the committee be safe to assume that if such a bill were passed by the Congress, that it would have the unqualified approval of the Treasury?

Mr. WILLIAMS. You are asking me now, sir, to judge what the Secretary's views would be. That has not been specifically discussed with him.

Senator KERR. Let me ask you this question: Based on the contents of this memorandum, would it not be safe to assume that such would be the case?

Mr. WILLIAMS. I would think so; yes, sir.

Senator KERR. Because, as I said a while ago, I want to congratulate the Secretary on the most lucid and informative statement on insurance taxation that I have ever seen presented to this committee since I became a member of it.

Mr. WILLIAMS. Thank you, sir.

Senator KERR. I believe that your estimate of free investment income which, if taxed at the normal corporate rate, would yield a revenue of $368 million, was based on the assumption that is stated in the next to the last paragraph on page 2, the second sentence:

> It is estimated that for 1955, they need only 75.5 percent of their investment income to meet their policy requirements.

Mr. WILLIAMS. Yes, sir.

Senator KERR. Was not that the record for 1954?

Mr. WILLIAMS. Yes. Normally, I believe, there is a 1-year lag in these figures.

Senator KERR. And had not the percentage of their investment income necessary to meet their policy requirements steadily declined each year from the figure of 87.5 percent in 1951, to 75.5 percent in 1954?

Mr. WILLIAMS. Yes, sir.

Senator KERR. And is not there a basis for the conclusion that the experience in 1955 will actually be that no more than 72.5 percent of their investment income will be required to meet their policy requirements?

Mr. WILLIAMS. I have seen a computation which indicates that 72.6 or 72.7, if my memory is correct——

Mr. Slitor, is that correct?

Mr. SLITOR. Yes, sir.

Senator KERR. You would not embarrass this modest member of this committee by calling attention to the difference between 72.5 and 72.6?

Mr. WILLIAMS. I beg your pardon. I certainly have no intention of doing so.

Senator KERR. In order that you and I may present a common front here, let us then agree between ourselves that the figure for the purposes of our conversation could be designated as 72.6 percent with very reasonable accuracy?

Mr. WILLIAMS. Yes, sir.

Senator KERR. That being the case, and if we used the realistic approach which was the basis of the 1950 act, was it——

Mr. WILLIAMS. Yes, sir.

Senator KERR. Of capturing approximately one-half of the free investment income, and if 72.6 is the accurate figure for 1955, which you and I have agreed we think it is, then the application of that principle would produce actually the $368 million which the memorandum indicates, based on the 75.5 percent, but in addition to that, half of it, approximately another $90 million?

Mr. WILLIAMS. I think that is correct, sir.

Senator KERR. So that would be 45 and 368; that would be $413 million. If we applied the formula of the 1950 act to the realities of 1955, which would be to capture half of the free investment income of the insurance companies and still leave free from taxation all of their profits from mortality experience, the relation between loading charges and operating costs, and from capital gains, the Treasury would receive nearly $200 million more in this 1-year period than they will receive under the terms of H. R. 7201.

Mr. WILLIAMS. I think that is correct, sir.

Senator KERR. Since we are concerned with the taxation of life-insurance companies for the tax year 1955, and since corporations have 3 months after the end of their tax year to file their returns, is it not true that we have until the end of March 1956 to adopt the law covering the taxation of life insurance companies for 1955?

Mr. WILLIAMS. It would be my opinion, sir, that any act passed prior to March 15, 1955, would be constitutional in its retroactive application.

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Senator KERR. You mean 1956?

Mr. WILLIAMS. 1956, yes, sir; I beg you pardon.

Senator KERR. Well, is it not a fact that that is what we did in 1950?

Mr. WILLIAMS. Substantially right.

Senator KERR. What is the difference if any, so far as the year of application is concerned, between the tax law for 1955, covering insurance companies, adopted in July 1955, and one adopted any time before March 31 of next year?

Mr. WILLIAMS. Well, it makes some difference to a company, of course, if they know what their tax is going to be, and how to plan their affairs.

Senator KERR. If action were taken here indicating that certain principles were to be the subject of further investigation by this committee, with the thought in mind that there was a purpose to apply suggested formulas to their revenues, would not that be a pretty fair notice to them of what they might expect by the law, even though it did not pass until March 1956?

Mr. WILLIAMS. Of course, that is a matter of opinion. In my opinion, it would be.

Senator KERR. That would be reasonably dependable notification?

Mr. WILLIAMS. Yes.

Senator KERR. As I understand H. R. 7201, higher deduction ratios are allowed with respect to policies under qualified employee pension plans, and to annuities and policyholder deposits.

Since these categories of business will vary from company to company and since there is nothing in the record to indicate its source, what is the authority for this statement that this bill will bring into the Treasury $26 million more than the stopgap formula which the bill replaced?

Mr. WILLIAMS. I shall have to ask Mr. Slitor to explain how our estimates were made. Will you do that, please?

Mr. SLITOR. There are a number of basic reforms in the bill which are responsible for that increase in revenue.

Senator KERR. Say that again.

Mr. SLITOR. There are several basic reforms that broaden the tax base and which are responsible for that additional revenue.

One is the addition of royalties and business income to the definition of investment income.

Senator KERR. Well now, those items must then be rather substantial?

Mr. SLITOR. They add a few million dollars; yes.

Senator KERR. Then they are substantial.

Mr. SLITOR. There are other items, however.

Senator KERR. But those you mentioned are substantial?

Mr. SLITOR. Yes.

Senator KERR. As a matter of equity, do you think that 6.5 percent tax on that kind of investment return is reasonable in view of the fact that all other corporations owning similar assets pay 52.5 percent?

Mr. WILLIAMS. May I suggest this, Senator, of course the element of net income must not be forgotten. After all, the insurance companies in writing their contracts—the contracts with their policyholders, on the basis of assumed income from investments—have contracted to pay out to their policyholders a portion of the earnings. So that, if I might be permitted to suggest a slight modification of the

proposition, the problem, as I see it, is roughly this: At the present time, in round figures, let us say, 25 percent of the investment income is what might be called loosely net profit.

Senator KERR. From the investments only?

Mr. WILLIAMS. That is correct, sir.

Now, then, under the present bill, 60 percent of that will be taxed because it is 15 percent of the total that will be taxed.

Senator KERR. Wait a minute. You have lost me. We have been getting along here and I have understood, I think, everything you have told me. Drive that one by again.

Mr. WILLIAMS. We start with the premise that 25 percent——

Senator KERR. Say that again.

Mr. WILLIAMS. Twenty-five percent of the investment income is free investment income.

Senator KERR. On the basis of the 1954 experience wherein 75.5 percent was declared?

Mr. WILLIAMS. Right.

Senator KERR. For the reserve requirement?

Mr. WILLIAMS. Right.

Now, the bill instead of taxing that 25 percent says that we are going to give the insurance companies an 85 percent credit—85 percent of their total investment income.

Senator KERR. That is instead of——

Mr. WILLIAMS. Instead of the 75.

Senator KERR. Instead of the 75-percent figure which was picked out on account of that being 1954, and instead of passing a bill which would tax what actually is the situation, and on the basis of our estimate which we have agreed on is 72.6, the bill says that we are just going to assume that you have to pay out 85 percent, which in reality is more than they have had to pay out in any of the last 3 years?

Mr. WILLIAMS. Yes, sir.

Senator KERR. And is not a realistic figure at all—it is just an arbitrary figure?

Mr. WILLIAMS. As I understand, it was deemed to be the average over a 20-year period. That is my understanding of the 85 percent—where it came from.

Senator KERR. Yes; but the only way that they could find a figure less realistic than one developed by applying a 20-year average, would be to take one that would represent less than 100 percent of the 20-year average, would it not?

Actually the experience of the last 5 years has been, and the trend is continuing, that the requirements to meet their reserves and other policy liabilities is less and less each year is rather substantial figures; that is the actual experience is it not?

Mr. WILLIAMS. It has been, yes, sir.

Senator KERR. So that this taking of an arbitrary figure just because it is a 20-year average figure would seem to be a device calculated to give the greatest benefit to the insurance companies and to enhance their position of having exemption from taxation; rather than being a device to cause them to pay an equitable part of their revenues in the form of taxes on the basis of what everybody else has to pay.

Mr. WILLIAMS. I do not believe, sir, that the proponents of the bill—that the subcommittee of the Ways and Means Committee

viewed it as such. I believe they viewed this as a method of arriving at a permanent solution of the total problem.

Senator KERR. I was asking as between you and me, what you thought?

Mr. WILLIAMS. Well, depending on your point of view, it may well have the effect that you outline.

Senator KERR. Regardless of the point of view, that is the result, is it not?

(Mr. Williams nodded.)

Senator KERR. The reporter does not record a nod. I wonder if you would reduce that to an affirmative answer, so that we could show that in the record.

Mr. WILLIAMS. Well, yes.

Senator KERR. That is your opinion—that is your opinion?

Mr. WILLIAMS. You will pardon me, Senator, but I would be very reluctant to answer that question affirmatively as a representative of the Treasury Department. After all, I am about the third or fourth echelon down, sir.

Senator KERR. I will tell you that I am for whatever echelon you are in. I will tell you that.

Mr. WILLIAMS. Thank you.

Senator KERR. You have given this committee more than any man that has been before it since I have been here. I want to congratulate you, sir.

Mr. WILLIAMS. Thank you, sir.

Senator KERR. Is there a good deal in what has been said to indicate a purpose on the part of some to create the impression that what we are doing here is just to make a 1-year stop-gap program so that we will have the opportunity for reexamination?

Mr. WILLIAMS. That is, sir, the very definite understanding so far as the Secretary of the Treasury is concerned, that this is a 1-year bill only.

Senator KERR. Do you not think, on the basis of this memorandum, that the joint committee staff and the Treasury have enough information to justify a more realistic bill than H. R. 7201, even for 1 year?

Mr. WILLIAMS. Well, I find it very difficult to answer that, sir. I think about all I can say is to repeat this in substance, that faced with a choice between the 1942 act, the 1951 act, and H. R. 7201, in our view, H. R. 7201 is superior to either of those other two.

Senator KERR. For a 1-year period?

Mr. WILLIAMS. Yes, sir, for a 1-year period.

Senator KERR. You still acknowledge the actuality of the availability of even better ones?

Mr. WILLIAMS. Yes, sir.

Senator KERR. Let me ask you this question: Does H. R. 7201 levy a tax on the free investment income of an individual life insurance company on the basis of its actual experience or on the basis of its so-called industry average?

Mr. WILLIAMS. The industry average approach is taken in this bill.

Senator KERR. Is it not a fact that every life insurance company has a different experience?

Mr. WILLIAMS. I think so.

Senator KERR. Is there any other industry wherein the individual taxpayer is taxed on the basis of the industry average instead of his own experience, that you know of?

Mr. WILLIAMS. Not to my knowledge, sir, no, sir.

Senator KERR. Is it not a fact that under this so-called industry average, the larger the company, the better its proportionate position under a tax levied on the industry average rather than on the experience of the individual company as a general matter?

Mr. WILLIAMS. I do not know, sir. Perhaps Mr. Slitor can answer your question.

Mr. SLITOR. I would not say that that was necessarily true. There has been under the 6.5 percent tax, and there is under this bill, a special relief feature for companies which do not earn their interest requirements.

Senator KERR. Ordinarily that is the smaller companies?

Mr. SLITOR. That is ordinarily the smaller companies—they are the primary beneficiaries of that relief feature.

Senator KERR. Is there any feature in the bill which would capture a proportionate part of the bigger company, that is, especially fortunate in this experience under this bill?

Mr. SLITOR. No.

Senator KERR. Does the Treasury have an estimate of what additional amount of tax would be obtained for the taxable year 1955 if the tax was made applicable to the individual companies instead of the industry average?

Mr. WILLIAMS. That would be about the same as the 1950 formula so far as revenue dollars to the Government are concerned.

Senator KERR. I thought that the estimate you and I had been using, that got us up to $415 million, was based on the tax figure being obtained on the basis of the industry average.

Mr. WILLIAMS. It was, sir, and yet my understanding, if it is correct, is that you will get the same result on the company-by-company approach.

Senator KERR. Is that your estimate?

Mr. SLITOR. Yes. The 1950 formula, as applied to 1955, would allow an industrywide average credit of 75.5 percent and, except for the 1-year lag of the industry credit, produce about the same aggregate revenue effect as taxing each company on an individual basis.

Senator KERR. Fifty-two percent of its net?

Mr. SLITOR. Except that the burden would be distributed differently among the companies.

Senator KERR. I see. I am very glad to have that information in the record.

Has any provision been made for a joint study of the proposal you and I have been discussing here by the Treasury staff and by Mr. Stam's committee, the Ways and Means Committee?

Mr. WILLIAMS. There is no formal arrangement of which I am ware.

Senator KERR. Let me ask you this—I take it that the Treasury has made a very comprehensive study of this program?

Mr. WILLIAMS. Yes, sir; a study which is of several year's duration, as I understand it.

Senator KERR. If this committee decided to take additional time to study this with the thought in mind of levying a more equitable tax, just for 1955, would the Treasury be in position to give us comprehensive and detailed information on this situation of the various companies and the amount of profit they are making, so that there would be no delay from the standpoint of securing necessary information in the formulation of a more equitable bill?

Mr. WILLIAMS. We could, I believe, provide you with all such information you might want, but we could not do it in 1 day's time or even in a week's time. It might be a matter of months.

Senator KERR. What I was trying to do was to ascertain your opinion as to how long it would take.

Mr. WILLIAMS. I would think, sir, that it would be a matter of, at least, 3 months to get, in addition to the investment income data, the data with respect to income from other sources, such as capital gains and the underwriting income and that sort of thing. To get all of that would take some months.

Senator KERR. You would have the data on the free investment income now?

Mr. WILLIAMS. Substantially, yes, sir.

Senator KERR. And certainly you have a considerable amount of information with reference to the income and losses for mortality experience, the ralation between loading charges and operating costs and capital gains profits?

Mr. WILLIAMS. We have a substantial amount. We are not satisfied with what we have.

Senator KERR. I understand.

Mr. WILLIAMS. We feel we need substantially more to make a final recommendation.

Senator KERR. To make the final recommendation?

Mr. WILLIAMS. Yes.

Senator KERR. But you do have substantial amounts of it?

Mr. WILLIAMS. Yes.

Senator KERR. And your judgment is that within 3 months time you could give the committee a rather complete picture?

Mr. WILLIAMS. I would say three to four months, yes, sir.

Senator KERR. And if a realistic approach was developed to apply the normal rate of taxation to that income, that would produce over and beyond the amount that you and I have talked about here, that ranges from $368 million to $415 million?

Mr. WILLIAMS. It would, sir.

Senator KERR. In your judgment, is there any basis for any life insurance company to pay its taxes on the basis of the industry average?

Mr. WILLIAMS. No, sir.

Senator KERR. Is it not a fact that that approach has been just a kind of convenient vehicle?

Mr. WILLIAMS. I think I should be very frank about that. In our opinion, there is very little greater ground for it in the insurance business than there is in manufacturing or for lawyers or doctors or anybody else. You do not compute the net taxable profit of manufacturing companies on the basis of the industry average. You do it on the individual basis, and we think in the insurance business, it should be the same.

Senator KERR. Such approach completely violates the basic principle of our income tax structure, does it not?

Mr. WILLIAMS. In our opinion, it does.

Senator KERR. I want to thank you again, Mr. Williams, very, very much for your frank and open discussion and for the very amazing amount of information you have on this subject.

Mr. WILLIAMS. Thank you, sir.

Senator BARKLEY. Mr. Chairman, I had no questions a while ago but the colloquy between Mr. Williams and Senator Kerr has stimulated my brain to ask a question or two.

Did this bill originate on the Hill or originate downtown?

Mr. WILLIAMS. It was presented to me, sir, by Mr. Mills and Mr. Curtis.

Senator BARKLEY. Who are they?

Mr. WILLIAMS. Of the Ways and Means Committee. They are members of the subcommittee, that has studied this bill.

Senator BARKLEY. Oh, I didn't know to whom you were referring. I know them both. They are members of the House Ways and Means Committee.

Mr. WILLIAMS. They discussed it with me.

Senator BARKLEY. It must have originated there.

Mr. WILLIAMS. I would assume so.

Senator BARKLEY. In view of the fact that you have been operating under the formula of 1942, and the formula of 1950, up to now, you must have gained a good deal of knowledge from experience in that operation; is there any reason why a complicated bill like this—and it is complicated because it deals with a complicated subject—should be rushed through the Congress here at the tail end of the session, and just for 1 year? What good does it do to pass a bill like this for 1 year; in order that you get some more experience on which to write another bill next year?

Mr. WILLIAMS. As I understand it, Senator, the problem is this: Since 1951, you have annually had a 1-year extension of the taxing formula of the 1951 act. That automatically has expired so that automatically the 1942 act will come into operation in the absence of legislation.

Senator BARKLEY. That being true, is there so much difference between those two acts that we should now pass a new act in a hurry, which has been proposed?

Mr. WILLIAMS. From the standpoint——

Senator BARKLEY. Until we gain further experience to write a new procedure?

Mr. WILLIAMS. First of all, from the standpoint of the companies themselves, whereas they would pay approximately $189 million under the 1951 approach, if the 1942 act automatically comes back in, which it would in the absence of legislation, the tax would jump to $274 million, a very substantial increase. So from their point of view, of course——

Senator BARKLEY. They prefer the 1951 act.

Senator KERR. No, they prefer——

Mr. WILLIAMS. From our point of view——

Senator BARKLEY. They prefer this act?

Mr. WILLIAMS. Yes H. R. 7201, from our point of view, does contain some desirable improvements. First of all, it broadens the definition of income so as to reach for tax purposes, types of income which under the 1942 act, 1951, and prior acts, have escaped tax. The loophole type of thing has developed. And this bill contains very desirable provisions to plug certain loopholes that do exist.

Investment companies which are really investment companies are masquerading, so to speak, as life insurance companies. This bill goes a long way toward closing that loophole.

The problem of whether it is fair to tax the income of insurance companies to the extent it represents pension plans, insured pension plans, when you do not tax the income of a pension trust—and the two are in fact competing with each other so that the large employer who can set up his own trust, his own pension trust, gets complete tax exemption of the income of that trust; but the little fellow who has to buy an insured plan, finds a tax on the income attributable to the investment of the amounts paid into that plan. And the leveling off, so to speak, of that competitive situation. There is a step taken in this bill in that direction. We think that it is desirable. So that the bill does have these various features which we think represent a substantial improvement.

Senator BARKLEY. Are they such improvements as you would recommend for inclusion in a permanent law?

Mr. WILLIAMS. I think so; yes, sir. I think these things I am talking about we would recommend be in the law permanently.

Senator BARKLEY. Do you think that the information you would be able to gather in the next 3 or 4 months in response to Senator Kerr's question, would be of appropriate value to this committee in considering permanent legislation next year?

Mr. WILLIAMS. I think so, sir—I would hope so.

Senator BARKLEY. In view of that, while it is not your function here to advise this committee, would it be worth waiting for, so far as effective and proper legislation is concerned, until January to pass even this bill for 1955, assuming we could pass it by March which is always doubtful?

Mr. WILLIAMS. I am not at all sure that between now and January we can develop a comprehensive, all-inclusive approach of the type that we think there should be for a permanent solution to the problem.

Senator BARKLEY. After many years of experience in the taxation of insurance companies, how long is it going to take for the Treasury to secure the proper information?

Mr. WILLIAMS. Unless and until you do get on a total-income, and company-by-company approach, no matter what you do by way of formula, something will happen two or three years later to turn it out of joint.

Senator BARKLEY. Life is just one postponement after another in the life of insurance companies?

Mr. WILLIAMS. That seems right.

Senator BARKLEY. That is all.

The CHAIRMAN. Senator Millikin, any questions?

Senator MILLIKIN. No questions.

The CHAIRMAN. Senator Martin?

Senator MARTIN. What percentage of our life insurance companies are mutual and what percentage are stock? You may have stated that.

Mr. WILLIAMS. I cannot tell you. Mr. Slitor may be able to tell you offhand.

Mr. SLITOR. About 75 percent of the business is mutual, as measured by the amount of their assets. However, in point of number of companies——

Senator MARTIN. I meant so far as the investments are concerned, rather than the number.

Mr. SLITOR. Seventy-five percent roughly is mutual.

Senator MARTIN. That is all.

Senator FLANDERS. I would like, sir, to get a clearer idea of your answer to one of the questions from the Senator from Oklahoma. He asked you in effect whether H. R. 7201 did not tend to reduce taxation of large companies and to increase it on small companies. I think you answered that it did.

Mr. WILLIAMS. I think I answered that I did not know and referred the question to Mr. Slitor. Mr. Slitor said—well, would you repeat whatever you said?

Mr. SLITOR. Well, the effect of the bill on a larger or smaller company—as compared, let us say, with the 6.5 percent tax—would depend to some extent on the amount of its pension trust business and individual annuity business.

Senator FLANDERS. Is it not then a question that it is favorable due to size itself? It is favorable simply due to the fact that the larger companies tend to carry more pension trust business; is that the answer?

Mr. SLITOR. Yes, sir.

Senator FLANDERS. I just wanted to make sure of that so that we were not considering this bill as a bill which favored larger companies, as such; but it does remove inequities in the pension trust business as between insurance pension trusts and private pension trusts; that is your reason for taking the pension trust business into consideration, and the only way in which size enters into it is due to the fact that it is the large companies in general which carry the heavy percentages of pension trust business. So this is not a question of favoring the big company because it is big, or making it a little harder for the little company because it is little.

Mr. WILLIAMS. I think that is correct, sir. And I would like to add, if I might, that there is one other area that is new here, and that is the extent of the portion of a company's business that is allocable to private annuities. Again they are given a different credit, instead of the 85-percent credit, leaving a tax on only 15 percent of free investment income. The credit starts out, I believe, at 90 percent, does it not, at the present time, under the bill?

Mr. SLITOR. Yes.

Mr. WILLIAMS So that again the impact of that on a particular company will depend on how much of its business is private annuity business. A company which has a large volume of that business in proportion to its total volume, will get a tax reduction because of that which a company which has no annuity business, of course, will not have.

Senator FLANDERS. That point, I think, is clear.

The next question I would like to raise would be this: Is it not true that if your hopes are realized in a new bill, and we go to the individual company basis—is it not true that a premium will be put on those companies which are a little less conservative in setting up their reserves?

Mr. WILLIAMS. It might. It might have that effect.

Senator FLANDERS. So that if we do that, we could expect a tendency toward a little less conservatism, where as if we average out for all the companies, a tendency is mitigated—there are always pulls toward a little less conservatism in business managements, but at least this pull would be relieved?

One other point, Mr. Chairman. I wish to make sure that I understand. There seems to be a pretty fairly definite commitment for a continuing study of this bill, resulting in presumably the bill to end all bills. I have not yet seen that hoped-for situation arriving in any legislation in the years that I have been in the Senate, but it is always hopefully viewed. And it seems to be in this case.

In the letter of Secretary Humphrey to the chairman of the House Ways and Means Committee, with which we are provided a copy, of July 7, since the letter was prepared the bill has been limited to 1 year only. I have discussed it with Mr. Mills and Mr. Curtis who assure me of their concurrence with our view that the whole problem should have further study and that further legislation should be developed for enactment next year. It seems to me that is a pretty definite commitment unless and until the chairman of the House Ways and Means Committee denies that he gave assurance of concurrence to that view.

So I think it seems to me, Mr. Chairman, that we must take it for granted that this bill to end all bills will be in the making, and I assume that the Treasury would be getting the information for it in these 3 or 4 months, between now and the beginning of the year, and that the House Ways and Means Committee, which has the responsibility for initiating tax laws, would be exercising due diligence in this matter in accordance with the assurances given to the Treasury.

I was also interested in what I understood to be your flat statement —and if you were not quite so flat as I thought you were, you can pad it up a bit—but I understood you to say that it was the opinion of the Treasury that for this coming year, H. R. 7201 was preferable to either the 1950 formula or the one that had been going on from 1951 through 1954.

Mr. WILLIAMS. I do not believe that is quite right, sir. If I said that, I misunderstood a question. What I tried to say is this, that choosing between the 1942 approach——

Senator FLANDERS. Yes.

Mr. WILLIAMS. The 1951 approach and H. R. 7201, we thought the latter preferable. I did not include the 1950 act in that statement.

Senator FLANDERS. You did not include the 1950 act?

Mr. WILLIAMS. That is right, sir.

Senator FLANDERS. I am glad to clear the record in that respect. What would be the effect of our throwing H. R. 7201 overboard and going back to 1950? Would the Treasury feel that was a mighty good thing to do?

Mr. WILLIAMS. We would be very happy to have the additional revenue, sir.

Senator FLANDERS. In other respects?

Mr. WILLIAMS. Well, as between the 1951 act and the 1950 act, and as between the 1942 act and the 1950 act, we think the 1950 act isa more logical approach to the problem and a more logical basis for taxation.

Senator FLANDERS. That is because it is on the individual company basis?

Mr. WILLIAMS. No; it is on the industry average basis, but it is on actual free investment income, not an artificial proportion of it.

Senator FLANDERS. So that if we were going to do anything other than give consideration to H. R. 7201, the Treasury would say, "Go back to the 1950 formula."

Mr. WILLIAMS. I think so; yes, sir.
Senator FLANDERS. Do you make that proposal?
Mr. WILLIAMS. No, sir.
Senator FLANDERS. Thank you.
The CHAIRMAN. Senator Carlson?
Senator CARLSON. May I ask if I understand this correctly? If Congress does nothing this session on this particular bill, do we then go back to the 1942 act?
Mr. WILLIAMS. Yes, sir.
Senator CARLSON. If we enact this bill, as I understand your statement, we would collect $215 million?
Mr. WILLIAMS. That is our estimate; yes, sir.
Senator CARLSON. And if we do, that is $26 million more than we would collect under the previous act; is that correct?
Senator KERR. No.
Mr. WILLIAMS. That is $26 million more than under the 1951 act, which has been extended several times.
Senator KERR. Not more than you have collected under the 1942 act?
Mr. WILLIAMS. No, sir. Under the 1942 act, it would be $274 million as opposed to $215 million.
Senator CARLSON. $26 million more than under the 1951 act?
Mr. WILLIAMS. Yes.
Senator BARKLEY. If we do not pass on this H. R. 7201, do nothing, automatically we go back to the 1942 act?
Mr. WILLIAMS. Yes.
Senator BARKLEY. In order not to go back to the 1942 act, but to go back to the 1950 or 1951 act, the formula, it would be necessary for Congress to pass a joint resolution of some kind extending that act, reenacting that act, instead of either the 1942 or this?
Mr. WILLIAMS. Yes, sir.
Senator BARKLEY. If we do not go back to the 1942 act, we have got to take some kind of positive action?
Mr. WILLIAMS. That is right.
Senator BARKLEY. Before this session adjourns? We can do it next year?
Senator KERR. We can do that any time between now and the end of next March.
Senator MARTIN. That is my understanding.
Mr. WILLIAMS. Let us say March 15, to be absolutely sure.
Senator BARKLEY. Is it March or April 15 now under the new act?
Mr. WILLIAMS. It is March 15.
Senator KERR. April 15 applies to individuals. The March date applies to corporations. Under the law, the corporation has 3 months beyond the end of the fiscal year.
Mr. WILLIAMS. Two and one-half months.
Senator KERR. Then it would be March 15, as you say, in order that we might be definitely certain that we were safe with reference to the 1955 taxes.
Mr. WILLIAMS. I would think so; yes, sir.
The CHAIRMAN. Thank you very much, Mr. Williams, for making a very frank statement
Mr. WILLIAMS. Thank you.
The CHAIRMAN. Our next witness is the Honorable Scott W. Lucas.
Senator MILLIKIN. I am glad to see you, Senator.

Mr. LUCAS. I am glad to see you.
The CHAIRMAN. We are very happy to welcome you to this committee, of which you were for so long a time a distinguished member. I wish we had you back here.

STATEMENT OF HON. SCOTT W. LUCAS, WASHINGTON, D. C.

Mr. LUCAS. Thank you very much, Mr. Chairman, for those very kind words.
Mr. Chairman, and gentlemen of the committee, I appear here as special counsel for the Acacia Mutual Life Insurance Co., whose headquarters are located in Washington, D. C. Associated with me on behalf of Acacia are its general counsel, Mr. Edward J. Schmuck, and its actuary, Mr. Lloyd Crippen.
Let me make our position clear on H. R. 7201. We are against it. I need not tell this committee that the taxation of life-insurance companies is one of the most complicated matters with which this committee has ever been concerned. It is such an involved matter that for the past few years a so-called stopgap formula has been annually reenacted in order to give the Congress an opportunity to study the matter thoroughly.
With this in mind, the House Ways and Means Committee early last year appointed a special subcommittee with the specific mission of developing a permanent formula for the taxation of life-insurance companies. Chairmaned last year by the Honorable Thomas Curtis, of Missouri, and this year by the Honorable Wilbur Mills, of Arkansas, this special subcommittee has worked hard and long, and last winter held hearings on the general subject of taxation of life-insurance companies. This subcommittee did not underestimate the complexities and ramifications of the problem. In fact, when H. R. 7201 was before the House on July 18, 1955, Congressman Mills said:

> Frankly, I know of no bill our committee has considered; I know of no bill the Congress has had before it during the time I have been a Member of this body, that is more complicated than this one relating to the taxation of life-insurance companies, because perhaps there is no business operated in the United States that has so many ramifications and is so complicated itself.

I submit that this committee, on that statement alone, should pass over this legislation until further information has been adduced by both the staff and the Treasury.
Yet, Mr. Chairman, nowithstanding this candid admission, the far-reaching bill was reported out by the House Ways and Means Committee with no hearings on the bill, and was adopted by the House under a suspension of the rules with 20 minutes of debate on each side.
That is why we are especially grateful to the chairman and members of this committee for an opportunity to comment on the bill. I do not minimize in the slightest the tremendous gratitude which is owed to Congressmen Mills and Curtis for their energy and devotion to this problem; but I must acknowledge how fortunate Acacia is that the Senate Finance Committee, on the eve of adjournment of Congress, is not going to be stampeded into rushing such an important bill through without giving industry representatives an opportunity to comment on that bill.
Mr. Chairman, Acacia is not the only one displeased with this bill. While Mr. Humphrey, Secretary of the Treasury, endorses a part of

it and is willing to go along with it for 1 year, yet he strikes hard at basic concepts of this measure when he says in a letter to Representative Cooper, chairman of the Ways and Means Committee:

I regret that the Treasury Department cannot unqualifiedly endorse H. R. 7201.

See Congressional Record Appendix, July 19, 1955, page A–5280.

The CHAIRMAN. Was that the letter that was read?

Mr. LUCAS. That is correct, Mr. Chairman, that is the letter that was read and which was commented on freely in the colloquy between Senator Kerr and Mr. Williams.

In that same letter, Mr. Humphrey further states that—

the proposed exclusion from the tax base of a flat 85 percent of investment income for ordinary life-insurance business does not appear to be justified.

This is the clause in the bill that is definitely beneficial to the insurance companies at the expense of the Treasury, as has been so thoroughly explained in the colloquy between Senator Kerr and Mr. Williams. And as will be thoroughly explained by Mr. Schmuck if any questions are asked.

It is interesting to note at this point that H. R. 7201 presents another stopgap formula for 1 year, the very thing the Congress has been trying to avoid since 1950 and the only reason for the appointment of a subcommittee in the House to find a permanent solution for eliminating this unsound approach once and for all.

Mr. Chairman, the Secretary of the Treasury in that same letter pointed the way toward how a permanent solution for the taxation of life-insurance companies can be found when he said the following:

On the basis of our review and examination, I suggest that an attempt be made to develop a method of taxing life-insurance companies like other business on the basis of their entire income from all sources, with appropriate deductions for their expenses and additions to their reserves against their policy contracts.

This provides for a company-by-company approach which is the principle that Hon. William Montgomery, president of Acacia and a veteran in the life-insurance business, has been fighting for for the past 25 years. It squares with the statement that I made before this committee in 1951, when I said:

Mr. Chairman, and gentlemen, sooner or later, the sooner the better, the Congress of the United States is going to have to recognize the principle that Mr. Schmuck is advocating here for the Acacia Mutual Life Insurance Co.—taxing life-insurance companies on a company-by-company basis and not on the averaging formula on which we have this stopgap legislation, which is utterly unsound, inequitable, and unfair to many smaller insurance companies in this country.

Mr. Chairman, we are indeed happy to find a sympathetic viewpoint in the Treasury of the United States. We agree with the Treasury and the House Ways and Means Committee that a further study and examination of the provisions of this bill should be undertaken during the next year. Where we disagree is that this bill should not become the law until after such an exhaustive study and investigation have been made. Why enact a law with all its complications until a study has been made by the staffs of the Treasury and the Congress of every feature, with testimony from every insurance company as to how this bill will affect them, as well as the Treasury, taxwise. The committee should know before passing this bill how it will affect taxwise the small insurance companies. Such evidence is

not available before the committee and cannot be made available without long and serious research, such as was suggested by Mr. Williams, which would take between 3 and 4 months.

They say, Mr. Chairman that all insurance companies are for this bill except Acacia. That is the situation we have had every since I have been representing Acacia. So what? Is that all the Congress needs to enact far-reaching legislation of this character? Mr. Chairman, I have the greatest respect for the ability and ingenuity of the lawyers who represent the big life-insurance companies. They are all estimable gentlemen, but it should be remembered that the insurance companies are their clients. They do not represent the legislative branch of the Government, which has the responsibility for writing the tax laws of the Nation.

I respectfully submit that they are not infallible. Witness what happened at previous times when this challenging question has been before the appropriate committees of Congress.

In February 1951, in hearings before the Ways and Means Committee, the industry committee advocated that the stopgap formula, the so-called industry average valuation rate formula, ultimately be made permanent legislation, and yet, we find approximately 3 months thereafter these same gentlemen testifying before the Finance Committee of the United States Senate, repudiating practically in toto their previous position before the Ways and Means Committee, telling the then members of the Finance Committee that the stopgap formula was bad legislation and should not prevail.

In July 1954, industry representatives appeared in an informal conference before the subcommittee of the Ways and Means Committee, advocating a three-pronged formula as permanent legislation. But lo and behold, in their formal testimony in December, they came forth with testimony advocating the 6½ percent stopgap formula as permanent legislation. And now we find them supporting H. R. 7201.

There is one thing I am proud of in representing Acacia. Its representatives have never altered or deviated from its position on the permanent taxation of life-insurance companies when called to testify before committees of Congress. Mr. Montgomery has consistently advocated the simple, direct, and equitable method of taxing life-insurance companies according to their own experience. Such perseverance for a principle is based upon his conviction that Congress should enact a tax formula which will give effect to the realities, as well as the theories, of the life-insurance business.

Mr. Chairman and gentlemen of the committee, it seems to me that, since H. R. 7201 merely presents again another form of stopgap legislation, with all of the complexities and questions implicit therein, no action should be taken on this measure until, as I have previously suggested, an exhaustive investigation is made by the staffs of the Treasury and congressional committees into every complex and complicated phase of this measure.

If the Congress should follow this suggestion and yet deem it necessary or advisable to enact a tax formula for life-insurance companies before the end of the present session, the present 6½-percent formula can be extended by a simple bill, and, if it is desired to increase the tax revenue to the $215 million predicted as a result of H. R. 7201, almost that identical figure could be produced merely by changing

the rate under the present stopgap formula from 6½ to 7½ percent. That can be done in executive session.

You will recall that Mr. Williams, in finishing his testimony said that he would prefer the 1950 stopgap formula to the 1951 act or the 1942 act, which we would go back to in the event no legislation was passed.

Mr. Chairman, such an approach will give to the staffs of the Treasury and the Congress sufficient time to develop factual information upon the complexities of H. R. 7201. Until that information is furnished the Congress, I submit that a sound and intelligent decision cannot be made by Congress on this measure. It will also give these same experts an opportunity to do the necessary reseacrh work on a plan submitted by the Treasury and heartily endorsed by Acacia—which is the taxation of life-insurance companies on a company-by-company basis.

In conclusion, may I be so bold as to say that were it not for the timely intervention of the Treasury, H. R. 7201 would have passed the House as permanent legislation. That is what the Industry Committee advocated because of the tremendous financial advantage to the industry. I do not believe that I am stretching my imagination by prophesying that if this bill is enacted into law, these representatives of the industry will be requesting Congress next year to continue this unsound and inequitable formula as permanent legislation.

The CHAIRMAN. Thank you.

Are there any questions?

Senator BARKLEY. Mr. Chairman, is it true that all of the companies, except the one you represent, are for this bill?

Mr. LUCAS. That is my understanding, Senator Barkley.

And I think that that question should be propounded to the gentlemen who are representing the so-called Industry Committee to ascertain whether or not they represent all of the insurance companies in this country, and whether or not they have polled the industry to ascertain whether they represent them all. That is the only way that you can find that out.

Senator BARKLEY. Personally, I am not going to be influenced by whether they are or are not against it.

Mr. LUCAS. I am sure of that.

Senator BARKLEY. Unanimously or only a part of it. It is interesting to know whether all of them, except the company you represent, are in favor of this particular bill.

Mr. LUCAS. I hope that when the gentleman testifies that he will be examined along that line, as to how many they do represent and whether there is any internal dissension among the companies on this very proposition.

Senator BARKLEY. So far as I am personally concerned, I do not think the amount of difference in the amount of revenue, as between the 1942 and 1950 acts, in this bill, is of vital concern, important as revenue is, to the Government at this time. It seems to me that the vital thing is to finally arrive at a point where you can write a permanent law that will tax insurance companies in this country, and if you lose a few million dollars, or gain a few million dollars in some years, in that approach, that it probably would average out in the long run.

Mr. LUCAS. I wholeheartedly agree with the Senator. The question of revenue is a factor but not the basic factor in attempting to write a law for the permanent taxation of life-insurance companies.

Senator BARKLEY. Did this House bill originally as introduced carry with it permanent duration?

Mr. LUCAS. The bill itself did not, as I understand it, but what the subcommittee started out to do and what they were authorized and directed under the resolution, was to find a permanent solution for the taxation of life-insurance companies.

As I said in my statement, I am satisfied that without the intervention of the Treasury at the proper time, this would have come forth as permanent legislation.

You will find in the Congressional Record that Mr. Curtis in making his statement before the House of Representatives indicated that he believed that they had found a solution for permanent taxation of life-insurance companies in this bill.

Senator BARKLEY. I gather from your statement that you believe that insurance companies ought to be taxed pretty much on the same basis as other corporations?

Mr. LUCAS. The Senator is absolutely correct, on a company-by-company basis.

Senator BARKLEY. Instead of having taxation left to themselves, and adjusting taxation among themselves?

Mr. LUCAS. The Senator is correct. And that has been my theory right along. And it is the theory of the Acacia Mutual Life Insurance Co. that I represent.

Did you have a question Senator Millikin?

Senator MILLIKIN. I said that I had no questions.

Mr. LUCAS. I always get seriously cross-examined when you ask me questions.

Senator MILLIKIN. Thank you very much.

Senator KERR. Would it be reasonable to assume that, as a basic principle, there is nothing to which taxpayers generally would so readily agree as a tax formula that would result in their paying the lowest possible tax?

Mr. LUCAS. I think that has been the experience of mankind from the beginning.

Senator KERR. And would the witness say that he recognizes there is a possibility that the application of that principle might explain the degree to which H. R. 7201 seems to be cherished by so many of the insurance companies?

Mr. LUCAS. I do not think there is any question about that. The insurance companies want to pay a tax, but they do not want to pay any more tax than they have to pay.

One of the things that I have always liked about the Acacia people is that they have been fighting for a principle and are willing to pay more taxes if necessary in order to put that principle into effect.

Senator KERR. Ordinarily, there is nothing more cherished by a taxpayer than a low rate and abundant exemptions.

Mr. LUCAS. The Senator is correct—the Senator is correct.

Senator KERR. Have you in your long experience in the Congress and in representing clients, ever seen a piece of legislation that would have such a high rating under the application of that principle as H. R. 7201?

Mr. LUCAS. Well, when you say "such a high rating" I do not know that I can make any comparison with other measures, but I know that this is an outrageous situation, insofar as the insurance companies are concerned, when it comes to paying a fair and equitable tax to the Treasury of the United States.

Senator KERR. Then I will go back to my question: Have you ever seen a proposed bill that would rate as high as a vehicle to provide a low rate of taxation and an abundance of exemptions as H. R. 7201?

Mr. LUCAS. No, I have not. If I understand your question, I have not. I sat here on this committee and considered a good many revenue measures for a number of years.

Senator KERR. Thank you.

Senator FLANDERS. Senator Lucas, is Acacia a mutual or stock company?

Mr. LUCAS. Mutual.

Senator FLANDERS. That is to its credit, in my judgment.

Mr. LUCAS. Thank you, sir.

Senator FLANDERS. May I inquire as to the quotation from Mr. Schmuck, on page 3 of your statement, the last 3 or 4 lines of that quotation:

> taxing life-insurance companies on a company-by-company basis and not on the averaging formula on which we have this stop-gap legislation, which is utterly unsound, inequitable and unfair to many smaller insurance companies in this country.

In what respect is it unfair to smaller life-insurance companies as distinguished from larger ones?

Mr. LUCAS. We think that it discriminates and we think that we have the facts to show that it has discriminated against the smaller insurance companies. That is a question that I would respectfully refer to Mr. Crippen, the actuary, or Mr. Schmuck, the general counsel, who are more familiar with those figures than I am. I made that statement in 1951 before this committee.

Senator FLANDERS. And the discrimination is related to size and not to the proportion of pension trust business carried?

Mr. LUCAS. I think that is correct.

Senator FLANDERS. Which is what we reduced this particular question to in the previous testimony.

Mr. LUCAS. I think that is correct, sir.

Senator FLANDERS. Much has been said about the desire which burns in every human heart to escape with the least possible burden of taxation. I am one of those who burn with that particular desire.

Mr. LUCAS. That is a very honorable confession that you have made, sir.

Senator FLANDERS. But in the case of the mutual companies, of which your company is one, is there any advantage to anyone except the policyholder—is not the policyholder's interest in lower taxation which is the only way in a mutual company in which that desire for lower taxation is instrumented or effected? He is the fellow who gets the advantage of the lower taxation?

Mr. LUCAS. The policyholder is the main fellow in all of these problems.

Senator FLANDERS. In a stock company, presumably the stockholders would be benefited, but in the mutual company like yours, the

question of the incidence of the beneficence of lower taxation applies to the policyholder.

Mr. LUCAS. The stockholder gets the benefit under the stock companies.

Senator FLANDERS. In the stock companies?

Mr. LUCAS. Yes.

Senator FLANDERS. And the policyholder in a mutual company?

Mr. LUCAS. That is correct.

Senator FLANDERS. That is all, Mr. Chairman.

Senator CARLSON. Mr. Chairman, just this one point. I notice that you stressed that we should try and write permanent taxation for life-insurance companies. I would sincerely hope that we could.

I am wondering about this, if this is not one form of business that is rather difficult to write on, on account of what is happening in that people are living longer, for instance. Where you write a policy that has been in existence for 20 years, written 30 years back, and they had a mortality rate and people were dying at a certain average age, and now it has been greatly extended—would that not continue, assuming that it does continue—would that not make it difficult to write a permanent legislation?

Mr. LUCAS. Let me answer this way. There is no more complicated piece of legislation than to attempt to write permanent legislation for life-insurance companies.

I attempted to make that statement clear, crystal clear in my manuscript that I have read before the committee. However, I honestly believe that on the company-by-company approach, you can write permanent legislation for life-insurance companies. That is exactly the position that we have taken all of these years. The objection that I have primarily to this bill is the complication and the complexities that are involved as was so magnificently stated by Congressman Mills on the floor of the House of Representatives.

Now, if it took 6 months for Congressman Curtis and Congressman Mills in seminars and informal hearings, and in study with the staffs, to finally come out with a bill without any hearings whatsoever before the Ways and Means Committee, and that bill is passed under suspension of the rules, and it comes here to the Senate Finance Committee, and this is the first time you gentlemen have had an opportunity to hear a witness on it, because I know how busy you all are, you have not had any opportunity to study this life-insurance question at all, other than what we have had here in previous years of testimony along this line. The point I am making, Senator Millikin and others, is that there should not be haste in passing a complicated measure of 38 pages, which the Treasury and everyone else says is not too good——

Senator MILLIKIN. Do you believe we ought to continue the present law?

Mr. LUCAS. I think that you ought to continue the present law for another year and raise the rate, if you want to raise the additional $28 million or $30 million, whatever is involved, to 7.5 percent, with a further study of this problem—the ramifications of this thing. For instance, with respect to your pension trusts and your annuities and all of those things—what evidence is there before this committee as to how it will affect the individual companies—every individual insurance company? It seems to me, this ought to be examined with a

view of how it will affect—how does it affect the small companies. Who is going to make up the difference here in the $30 million, that is, in revenue? Is it the larger company that gets the benefit, or is it the small company? Who knows as a result of what evidence is before this committee?

I undertake to say that evidence cannot be gained overnight. It will take, as Mr. Williams said, 3 or 4 months to get that information. This is too important a measure to just pass without any evidence at all on the different complications that are involved in this 38-page bill.

I know how the Senator from Colorado, who has acted on measures of this kind before, feels. He is one of the most thorough men in the Congress. He wants an exhaustive study made. He wants the facts before him, before he will pass on them.

Senator BARKLEY. Be careful, he is a condidate for reelection next year.

Mr. LUCAS. But I want to say, if I were from Colorado, I would vote for him.

Senator MILLIKIN. Good for you, why do you not move out there?

Mr. LUCAS. I may move out there.

Senator CARLSON. I just wanted to make the one point. If I remember correctly, and I am not a student of life insurance, I assure you——

Mr. LUCAS. I do not know whether anyone is, Senator Carlson.

Senator CARLSON. It seems to me that back in the thirties, some of the very large insurance company people decided that this was stagnant, we were going to remain at 130 million to 140 million people. We were not going to change. That would be the maximum of our population. I noticed that they have had to revise that. We have 165 million people now.

Mr. LUCAS. That is correct. That may have something to do with this problem. I am not sure that it does.

Senator CARLSON. I think you made a very good statement.

Senator BARKLEY. The longer you live, the better off the insurance companies are.

The CHAIRMAN. Thank you very much.

Mr. LUCAS. Thank you, Mr. Chairman, and gentlemen.

The CHAIRMAN. The next witness is Mr. Edward J. Schmuck, general counsel of the Acacia Mutual Life Insurance Co., accompanied by Lloyd Crippin, vice president, Acacia Mutual Life Insurance Co.

STATEMENT OF EDWARD J. SCHMUCK, GENERAL COUNSEL, ACACIA MUTUAL LIFE INSURANCE CO., ACCOMPANIED BY LLOYD CRIPPIN, VICE PRESIDENT, ACACIA MUTUAL LIFE INSURANCE CO.

Mr. SCHMUCK. My name is Edward J. Schmuck. I am general counsel for the Acacia Mutual Life Insurance Co., domiciled here in Washington, D. C.

I am pleased to state that due to the testimony and the colloquy with Mr. Williams a considerable portion of my statement has become redundant. However, I believe that there are portions of it which may either expand or clarify 1 or 2 of the points that were raised, and with your permission I would like to go through the statement.

Senator BARKLEY. I suggest that he be permitted to file the entire statement for the record and to comment on such portions as he may think desirable.

Mr. SCHMUCK. Thank you, sir.

The CHAIRMAN. Without objection the entire statement will be put into the record.

Mr. SCHMUCK. It is our firm conviction that there never can be or will be a sound permanent formula for the taxation of life-insurance companies unless it, first, imposes the tax on a company-by-company basis, under a formula which will determine the taxable income of each company on the basis of its individual operating results and not on the basis of an industrywide average or other arbitrary factors; and, second, realizes for the Government the full amount of tax revenues to which it is entitled on the full measure of each company's taxable income.

We have directed our attention in the relatively brief time available to us to what we think is the key provision of the bill, the provisions which determine the so-called life-insurance taxable income of the individual company as the result of the deduction which is allowed for the reserve and other policy liabilities. What we usually call our required interest.

This bill provides a formula for the determination of this deduction which is new in detail, but it continues to provide the deduction for the individual company on a uniform basis which, with some variations newly introduced into the present formula, takes no account of the individual experience of the company.

From the standpoint of the Government, the rate of the uniform deduction is excessive in terms of the current and foreseeable future required interest of the companies as a whole. The formula, therefore, provides substantially less tax revenues than the industry as a whole has the capacity to pay, even on the theory underlying the present bill.

Since 1921, as Mr. Williams briefly stated, life-insurance companies have been taxed on the basis of their investment income. Premium income and the mortality gains and possible loading gains resulting therefrom, and capital gains are excluded from the tax base.

Investment income less the defined investment expenses, tax-free interest, and the interest required to fulfill contract obligations and statutory requirements for policyholders and beneficiaries, determines the amount of investment income which is the so-called free interest.

Free interest, under the theory underlying the several tax laws affecting life-insurance companies which have been enacted since 1921, is the measure of the taxable income of the companies.

However, the deduction for required interest has been expressed consistently as a uniform rate of deductions for all companies. From 1921 to 1942 each company took a deduction of a specified statutory percentage of its assets to cover its required interest. In the 1942 law, the required interest was averaged for the industry as a whole and each company applied the resulting ratio to its own investment income in determining the deductions. When this formula produced no tax on the life-insurance business for the years 1947 and 1948, a new averaging method was devised as a stopgap for 1949 and 1950.

This, in turn was replaced by the so-called 6.5 percent formula which was effective from 1951 to 1954.

The effect of all of these formulas was such that at no time was all the free interest of all the companies taxed. Conversely, because of the uniform rate of deduction provided for all companies, some companies have been granted substantial tax preferences while others have been subjected to excessive taxation.

Senator KERR. Comparatively speaking?

Mr. SCHMUCK. In some cases actually speaking.

Senator KERR. But generally comparatively?

Mr. SCHMUCK. Generally comparatively, yes, sir.

H. R. 7201 imposes upon life-insurance companies a tax at the regular corporate tax rates on their "life-insurance taxable income" plus, for those companies which conduct a cancelable accident and health-insurance business, a tax on 1 of 2 alternate and, for life-insurance companies, totally new bases.

The starting point for the determination of the life-insurance taxable income is the gross investment income of the companies. Of course, as has been testified here, there are definite improvements in H. R. 7201 in the definition of the gross investment income. Then you take off investment expenses. After that you are down to the net investment income.

Changes in the definition of gross investment income on the whole appear to be reasonable improvements over the old definition. From the gross investment income, deductions are allowed, as under previous laws, for tax-free interest, investment and real-estate expenses and depreciation. Because of the changes in the definition of gross-investment income, new deductions are provided in H. R. 7201 for depletion and operating expenses of a business other than an insurance business operated by a life-insurance company. The remainder after the deduction of these items from gross investment income is defined in the bill as net investment income.

Net investment income less deductions for (1) reserve and other policy liability, (2) net investment income allocable to non-life-insurance reserves, and (3) the special interest deduction, if any, allowed to companies not earning or barely earning their individual required interest, produces the amount which is the life-insurance taxable income of the companies.

THE REQUIRED INTEREST DEDUCTION

We have devoted our major attention, in the limited time available to us since H. R. 7201 was introduced, to the deduction for reserve and other policy liabilities, the required interest deduction, which is the key provision of the method provided in H. R. 7201 for determining the life-insurance taxable income.

The proposed formula in the pending bill states that each life-insurance company shall take as its deduction for reserve and other policyholder interest obligations a basic 85 percent of its net investment income, except that it shall deduct 90 percent—increasing progressively over 5 years to 95 percent—of its net investment income allocable to reserves for annuity contracts and deposits and 92.5 percent—increasing progressively over 5 years to 100 percent—of its net income allocable to pension plan reserves.

EFFECT UPON THE GOVERNMENT

The basic 85 percent deduction bears no relation at this time to the free interest of the life insurance industry as a whole or of the individual life-insurance companies. For 1955, it is estimated that, for the industry as a whole, the aggregate required interest of all life-insurance companies is about 72.5 percent of their aggregate net investment income. This percentage has been steadily decreasing since 1949.

In the foreseeable future it will continue to decrease. For 1955 the proposed formula would tax less than 60 percent of the aggregate free interest of the companies. Our calculations indicate that if all life-insurance companies were taxed for the year 1955, each on its own free interest, the aggregate tax revenues of the Government would be approximately $375 million. As was brought out here, this estimate is conservative, and the amount might actually run as high as $410 million or $415 million for this tax year. This compares with the $215 million of revenue predicted under H. R. 7201.

Fixing the required interest basic deduction at 85 percent has the effect, as did the 6.5 percent formula, of freezing the maximum percentage of the aggregate net investment of the life-insurance companies which would be subjected to taxation. Thus, in view of the trends which are producing a steady decrease in the percentage of investment income needed for reserve and other policyholder obligations, the proposed formula will have the result of taxing, in the predictable future, a steadily decreasing percentage of the aggregate free interest of the companies.

I do not believe, sir, that that point has been made here this morning. The statement by the representative of the Treasury Department, I think, so well and fully covered the effect upon Federal revenues that I would like to skip, if I may, to the effect of this bill among the life-insurance companies.

We are in total accord with the expressions of the Secretary of the Treasury that the tax imposed upon life-insurance companies should be fairly distributed among the companies and should be fair in relation to the tax burdens of other savings institutions and taxpayers generally. We think that it is demonstrable and, as further testing of the tax formula in H. R. 7201 becomes possible, it will become increasingly apparent that the proposed tax formula fails to fulfill these conditions.

The Secretary of the Treasury has proposed to explore the possible development of a tax formula based on the total net income of life-insurance companies, taking account of the special situations involved in their operations. This approach has the virtue, which the present bill does not, of exploring a tax formula which will be on a company-by-company basis in its entirety. We are in strong accord with the necessity for exploring each and every formula for the taxing of life-insurance companies on an individual company basis.

There are two conceptions incorporated in the tax formula of H. R. 7201 which make it obvious almost without the necessity of discussion that the formula cannot and will not make a fair and equitable distribution of the tax burden among the life-insurance companies.

First and foremost is the fact that the basic 85 percent required interest deduction is uniform for all companies, without regard to the

actual requirements of the individual companies. Second, and to a degree compounding the inequities of this uniform deduction, is the fact that the new formula then goes on to allow individual companies to increase their required interest deduction on the basis of their individual experience in limited areas.

Obviously, if the aggregate required interest of the life-insurance business is only 72.5 percent of the aggregate net investment income for 1955, most companies, necessarily including the largest companies, have interest requirements substantially below 85 percent. These, of course, derive a windfall from the proposed formula.

On the other hand, companies having interest requirements in excess of the 85 percent basic deduction allowed by the proposed formula would be subject to gross discrimination under the arbitrary-deduction provision of the bill. They must pay taxes in excess of what would be their normal liability if taxable income were computed on the basis of their own operating results.

Partial recognition is given to the essential illogic and unfairness of the flat percentage deduction by the provision of the bill, carried over from the 6.5 percent formula, which allows a special interest deduction for companies which have net investment income less than 105 percent of their required interest. The special interest deduction is computed on the basis of the individual company's experience. This deduction can result in as much as a 50 percent reduction in the tax otherwise due.

It is desirable, even necessary, that such companies receive special relief from the tax burden that would otherwise be imposed upon them by reason of the uniform required interest deduction. However, there is still no provision for relief for companies whose required interest is more than 85 percent but less than 100 percent of their net investment income. As a result, slight variations among individual companies in the relationship between their net investment income and their required interest can produce major variations in their tax liability. We submit that there is neither reason nor equity in a tax law so devised.

There are in the new formula two more major areas in which the operating experience of the individual company supersedes the 85 percent uniform basic required interest deduction. These are the special deductions allowed with respect to pension plan reserves and annuity and policyholders deposit reserves. These special deductions allow the individual company a full ultimate 100 percent deduction of its net investment income allocable to pension plan reserves and 95 percent of its net investment income allocable to annuities and deposits.

Thus, significant tax relief is afforded those companies which, under their individual operating philosophies, have entered substantially into the pension plan and annuity fields. However, no account is taken in the bill of any other substantial differences in the operating principles and results that may exist among the companies, such as premium rate structure, policy provisions and obligations, and interest guaranties.

As a result of the special pension plan and annuity reserves deductions, some companies which will benefit thereby will pay even less taxes on their life insurance business than if the 6.5 percent formula were continued. By comparison, other companies will pay more

taxes under the proposed formula than under the 6.5 percent formula, in varying amounts up to 20 percent additional.

One of the problems in testing the effect of H. R. 7201 in the time that has been available to us is the lack of readily available data with respect to a number of the new factors introduced into the formula, including the pension plan and annuity reserve special deductions. Even the annual statement data filed with the State insurance departments, the most complete data available to us, contains no precise breakdown of information allowing a completely accurate testing of the effect upon individual companies of the formula proposed by H. R. 7201. However, with the data available, we have calculated for a small number of the largest companies doing business in the District of Columbia what we believe to be a reasonably accurate approximation of the relative effect of the proposed formula among these companies.

Our calculations indicate that of 20 companies so tested to date on the basis of their 1954 operating results, 3 of the largest would have paid less tax under the proposed formula than under the 6.5-percent formula. The remaining 17 companies so tested apparently would have paid between 108 percent and 120 percent of the taxes actually payable by them for the year 1954 under the 6.5-percent formula.

Time and unavailability of precise data have not permitted the necessary analyses and testing to determine whether the new tax formula would impose the greater incidence of tax increase upon the larger or the smaller companies. However, the very nature of the pension and annuity reserve adjustments would indicate that the smaller and especially the younger companies could expect little tax relief from these adjustment provisions but that some of the larger and older companies which have been especially active in those fields would derive very material tax remission from these special deduction provisions.

It is our firm conviction that here again the proposed formula is lacking in equity in the distribution of the tax burden among the companies and that there can be no long-range validity to a tax formula that will produce such discriminatory results by reason of special advantages for some companies based on their particular and individual operating procedures.

In the interest of conserving time, I will skip the next section which points out that in our exploration of the bill, we discovered a number of very serious questions not only of interpretation but of the effect and application of various of the technical provisions of the bill. This was highpointed by the fact that after the bill was introduced, but prior to its passage in the House, two amendments were made, one of which was certainly imperative for the newly organized companies and is designed to afford to such companies a measure of relief from one of the limitations in H. R. 7201.

However, it may be that that amendment is defective in that it does not guard against the possibility of the organization of successive new life-insurance companies, each of which then would be entitled to a 5-year remission under the provisions of that amendment as we read it.

In short, we feel that in this bill there are implicit so many questions that to ask the Senate of the United States to act at this last moment of the present session is to ask you to run almost blind.

H. R. 7201 contains a number of provisions which, in basic intent, are clear improvements over prior laws. These include the redefinition of a life-insurance company and of gross investment income and the concept of a limitation upon the required interest deduction to minimize the use of the life insurance company form for tax avoidance purposes. However, it is evident—and the amendment of the bill established by adding section 818 is quite convincing evidence—that there are many questions about these and numerous other provisions of the bill.

The Secretary of the Treasury has indicated the dissatisfaction of that Department of the Government with the proposed new tax formula. We have attempted to point out to your committee some of the more significant features of the bill which in our judgment constitute basic defects. There are so many obvious inequities in the bill, resulting in part from the basic averaging concept upon which it is based and in part upon the effort to correct some, but not all of the problems resulting from that concept by providing for some companies' adjustments based on their individual methods of operation. There is an inadequacy of readily available data to test fully and precisely the effect of the many new and highly technical features of the bill upon and among the companies. There is no need for the haste that has characterized the legislative history of H. R. 7201.

Traditionally, the Congress in enacting tax laws has recognized the great economic, social, and moral values of life insurance. This special recognition is reflected in the provisions of the tax law relating to life-insurance proceeds received by policyholders and their beneficiaries and in the separate and special tax treatment that has been granted to the life-insurance companies.

These privileges, in our opinion, cannot be justified unless all life-insurance companies are prepared fully to fulfill their tax obligations on a basis which is fair to the Government and which is fair and equitable as among the life-insurance companies. We believe that H. R. 7201 patently fails to accomplish these two objectives. We ask that it not receive the approval of your committee.

The CHAIRMAN. Thank you very much, Mr. Schmuck. We will include your entire statement in the record at this point.

(The prepared statement of Mr. Schmuck is as follows:)

STATEMENT OF EDWARD J. SCHMUCK, ON BEHALF OF ACACIA MUTUAL LIFE INSURANCE CO.

It is our firm conviction that there never can be or will be a sound permanent formula for the taxation of life-insurance companies unless it:

1. Imposes the tax on a company-by-company basis, under a formula which will determine the taxable income of each company on the basis of its individual operating results and not on the basis of an industrywide average or other arbitrary factors; and
2. Realizes for the Government the full amount of tax revenues to which it is entitled on the full measure of each company's taxable income.

H. R. 7201 violates both of these principles.

The key provision of the method provided in H. R. 7201 for determining the life insurance taxable income of the individual company is the deduction allowed for the reserve and other policy liabilities, the so-called required interest deduction. While the bill provides a formula for the determination of this deduction which is new in detail, it continues to provide the deduction for the individual company on a uniform basis which, with some variations newly introduced into the present formula, takes no account of the individual experience of the company.

From the standpoint of the Government, the rate of the uniform deduction is excessive in terms of the current and foreseeable future required interest of the

companies as a whole. The formula, therefore, provides substantially less tax revenues than the industry as a whole has the capacity to pay, even on the theory underlying the present bill.

BACKGROUND

Since 1921, as Mr. Williams briefly stated, life-insurance companies have been taxed on the basis of their investment income. Premium income, and the mortality gains and possible loading gains resulting therefrom, and capital gains are excluded from the tax base. Investment income, less the defined investment expenses, tax-free interest, and the interest required to fulfill contract obligations and statutory requirements for policyholders and beneficiaries, determines the amount of investment income which is the so-called free interest. Free interest, under the theory underlying the several tax laws affecting life-insurance companies which have been enacted since 1921, is the measure of the taxable income of the companies.

However, the deduction for required interest has been expressed consistently as a uniform rate of deduction for all companies. From 1921 to 1942 each company took a deduction of a specified statutory percentage of its assets to cover its required interest. In the 1942 law, the required interest was averaged for the industry as a whole and each company applied the resultant ratio to its own investment income in determining the deduction. When this formula produced no tax on the life-insurance business for the years 1947 and 1948, a new averaging method was devised as a stopgap for 1949 and 1950. This, in turn, was replaced by the so-called 6½-percent formula which was effective from 1951 to 1954.

The effect of all these formulas was such that at no time was all the free interest of all the companies taxed. Conversely, because of the uniform rate of deduction provided for all companies, some companies have been granted substantial tax preferences while others have been subjected to excessive taxation.

H. R. 7201 not only continues, but in our opinion, because of some of its new provisions accentuates these results of the use of uniform averages in the formula for taxing life companies.

H. R. 7201 imposes upon life-insurance companies a tax at the regular corporate tax rates on their "life insurance taxable income" plus, for those companies which conduct a cancelable accident and health insurance business, a tax on 1 of 2 alternate and, for life-insurance companies, totally new bases.

The starting point for the determination of the life insurance taxable income is the gross investment income of the companies. Changes in the definition of gross investment income on the whole appear to be reasonable improvements over the old definition. From the gross investment income, deductions are allowed, as under previous laws, for tax-free interest, investment and real-estate expenses and depreciation. Because of the changes in the definition of gross investment income, new deductions are provided in H. R. 7201 for depletion and operating expenses of a business other than an insurance business operated by a life-insurance company. The remainder after the deduction of these items from gross investment income is defined in the bill as net investment income.

Net investment income less deductions for (1) reserve and other policy liability, (2) net investment income allocable to nonlife insurance reserves, and (3) the special interest deduction, if any, allowed to companies not earning or barely earning their individual required interest, produces the amount which is the life insurance taxable income of the companies.

THE REQUIRED INTEREST DEDUCTION

We have devoted our major attention, in the limited time available to us since H. R. 7201 was introduced, to the deduction for reserve and other policy liabilities, the required interest deduction, which is the key provision of the method provided in H. R. 7201 for determining the life insurance taxable income.

The proposed formula in the pending bill states that each life-insurance company shall take as its deduction for reserve and other policyholder interest obligations a basic 85 percent of its net investment income, except that it shall deduct 90 percent (increasing progressively over 5 years to 95 percent) of its net investment income allocable to reserves for annuity contracts and deposits and 92½ percent (increasing progressively over 5 years to 100 percent) of its net income allocable to pension-plan reserves.

Effect upon the Government

The basic 85 percent deduction bears no relation at this time to the free interest of the life-insurance industry as a whole or of the individual life-insurance com-

panies. For 1955, it is estimated that, for the industry as a whole, the aggregate required interest of all life-insurance companies is about 72.5 percent of their aggregate net investment income. This percentage has been steadily decreasing since 1949. In the foreseeable future it will continue to decrease. For 1955 the proposed formula would tax less than 60 percent of the aggregate free interest of the companies. Our calculations indicate that if all life-insurance companies were taxed for the year 1955, each on its own free interest, the aggregate tax revenues of the Government would be approximately $375 million. This compares with the $215 million of revenue predicted under H. R. 7201.

Fixing the required interest basic deduction at 85 percent has the effect, as did the 6½ percent formula, of freezing the maximum percentage of the aggregate net investment of the life-insurance companies which would be subjected to taxation. Thus, in view of the trends which are producing a steady decrease in the percentage of investment income needed for reserve and other policyholder obligations, the proposed formula will have the result of taxing, in the predictable future, a steadily decreasing percentage of the aggregate free interest of the companies.

During the discussion preceding the enactment of H. R. 7201 in the House of Representatives, there were introduced in the record two letters from the Secretary of the Treasury addressed to the chairman of the Committee on Ways and Means (Congressional Record, pp. 9326 and A5280–1). For the convenience of your committee, copies of these letters are appended to this statement. With your permission, I would like to read them.

The statements of the Secretary of the Treasury confirm the effects of the pending bill upon the tax revenues which we have just discussed. Therefore, without further elaboration on this point, we would like to turn to the effect of the proposed tax formula upon and among the companies composing the life-insurance business.

Effect among the companies

We are in total accord with the expressions of the Secretary of the Treasury that the tax imposed upon life-insurance companies should be fairly distributed among the companies and should be fair in relation to the tax burdens of other savings institutions and taxpayers generally. We think that it is demonstrable and, as further testing of the tax formula in H. R. 7201 becomes possible, it will become increasingly apparent that the proposed tax formula fails to fulfill these conditions. The Secretary of the Treasury has proposed to explore the possible development of a tax formula based on the total net income of life-insurance companies, taking account of the special situations involved in their operations. This approach has the virtue, which the present bill does not, of exploring a tax formula which will be on a company-by-company basis in its entirety. We are in strong accord with the necessity for exploring each and every formula for the taxing of life-insurance companies on an individual company basis.

There are two conceptions incorporated in the tax formula of H. R. 7201 which make it obvious almost without the necessity of discussion that the formula cannot and will not make a fair and equitable distribution of the tax burden among the life-insurance companies.. First and foremost is the fact that the basic 85 percent required interest deduction is uniform for all companies, without regard to the actual requirements of the individual companies. Second, and to a degree compounding the inequities of this uniform deduction, is the fact that the new formula then goes on to allow individual companies to increase their required interest deduction on the basis of their individual experience in limited areas.

Obviously, if the aggregate required interest of the life-insurance business is only 72.5 percent of the aggregate net investment income for 1955, most companies, necessarily including the largest companies, have interest requirements substantially below 85 percent. These, of course, derive a windfall from the proposed formula. On the other hand, companies having interest requirements in excess of the 85 percent basic deduction allowed by the proposed formula would be subject to gross discrimination under the arbitrary deduction provision of the bill. They must pay taxes in excess of what would be their normal liability if taxable income were computed on the basis of their own operating results.

Partial recognition is given to the essential illogic and unfairness of the flat percentage deduction by the provision of the bill, carried over from the 6½ percent formula, which allows a special interest deduction for companies which have net investment income less than 105 percent of their required interest. The special interest deduction is computed on the basis of the individual company's experience. This deduction can result in as much as a 50 percent reduction in the tax otherwise due. It is desirable, even necessary, that such companies receive

special relief from the tax burden that would otherwise be imposed upon them by reason of the uniform required interest deduction. However, there is still no provision for relief for companies whose required interest is more than 85 percent but less than 100 percent of their net investment income. As a result, slight variations among individual companies in the relationship between their net investment income and their required interest can produce major variations in their tax liability. We submit that there is neither reason nor equity in a tax law so devised.

There are in the new formula two more major areas in which the operating experience of the individual company supersedes the 85 percent uniform basic required interest deduction. These are the special deductions allowed with respect to pension-plan reserves and annuity and policyholder deposit reserves. These special deductions allow the individual company a full ultimate 100-percent deduction of its net investment income allocable to pension-plan reserve and 95 percent of its net investment income allocable to annuities and deposits. Thus, significant tax relief is afforded those companies which, under their individual operating philosophies, have entered substantially into the pension plan and annuity fields. However, no account is taken in the bill of any other substantial differences in the operating principles and results that may exist among the companies, such as premium-rate structure, policy provisions and obligations, and interest guaranties.

As a result of the special pension plan and annuity reserves deductions, some companies which will benefit thereby will pay even less taxes on their life-insurance business than if the 6½-percent formula were continued. By comparison, other companies will pay more taxes under the proposed formula than under the 6½-percent formula, in varying amounts up to 20 percent additional.

One of the problems in testing the effect of H. R. 7201 in the time that has been available to us, is the lack of readily available data with respect to a number of the new factors introduced into the formula, including the pension plan and annuity reserve special deductions. Even the annual statement data filed with the State insurance departments, the most complete company data available to us, contains no precise breakdown of information allowing a completely accurate testing of the effect upon individual companies of the formula proposed by H. R. 7201. However, with the data available, we have calculated for a small number of the largest companies doing business in the District of Columbia what we believe to be a reasonably accurate approximation of the relative effect of the proposed formula among these companies. Our calculations indicate that of 20 companies so tested to date on the basis of their 1954 operating results, 3 of the largest would have paid less tax under the proposed formula than under the 6½-percent formula. The remaining 17 companies so tested apparently would have paid between 108 percent and 120 percent of the taxes actually payable by them for the year 1954 under the 6½-percent formula. Time and unavailability of precise data have not permitted the necessary analyses and testing to determine whether the new tax formula would impose the greater incidence of tax increase upon the larger or the smaller companies. However, the very nature of the pension and annuity reserve adjustments would indicate that the smaller and especially the younger companies could expect little tax relief from these adjustment provisions but that some of the larger and older companies which have been especially active in those fields would derive very material tax remission from these special deduction provisions.

It is our firm conviction that here again the proposed formula is lacking in equity in the distribution of the tax burden among the companies and that there can be no long-range validity to a tax formula that will produce such discriminatory results by reason of special advantages for some companies based on their particular and individual operating procedures.

QUESTIONS CONCERNING H. R. 7201

There are other new provisions of H. R. 7201 which we have not had the opportunity to carefully test, which raise serious question. For example, after the bill was reported out by the Committee on Ways and Means but before it was passed in the House, section 818 was added to the bill. This amendment, we understand, resulted from the protests made on behalf of a number of newly organized companies. Its purpose appears to be to grant such new companies relief from a tax burden that could otherwise result to them by reason of a provision of the bill, new in concept, which establishes, in the basic tax formula of H. R. 7201, a maximum limit for the required interest deduction. This provision for a maximum has the worthwhile objective of minimizing the tax advantage of those who have

organized life-insurance companies merely as an investment medium, without any intention of actively serving the insuring needs of the public, but with the definite purpose of taking advantage of the preferential tax position accorded to life-insurance companies. Stated generally, the limitation in the new formula is that the required interest deduction shall not exceed two times the actual required interest of the individual company plus certain additional defined interest and dividends to policyholders.

The amendment in section 818 provides that, despite this limitation, the life-insurance taxable income during the first 5 years of a company's existence shall not exceed the net gain from operations of the company, less an adjustment related to accident and health business. "Net gain" is defined by reference to the annual statement of the company. A further adjustment is provided in such instances for a dividends-received deduction which is denied to the life-insurance companies under the basic formula.

It may well be that these amendments are necessary and advisable to allow the growth of new companies. However, the very fact that they had to be absorbed into the bill, prior to adoption, as exceptions to the basic formula, gives added weight to the many questions that are raised by study of the bill and which should be thoroughly explored before H. R. 7201 is enacted into law. As a matter of fact, the amendment itself raises a question, for there is no apparent limitation upon the creation of successive new life-insurance corporations, each of which presumably would be entitled to the benefit of the 5-year tax-relief provision.

CONCLUSION

H. R. 7201 contains a number of provisions which, in basic intent, are clear improvements over prior laws. These include the redefinition of a life-insurance company and of gross investment income and the concept of a limitation upon the required interest deduction to minimize the use of the life-insurance company form for tax avoidance purposes. However, it is evident—and the amendment of the bill established by adding section 818 is quite convincing evidence—that I have just referred to—that there are many questions about these and numerous other provisions of the bill. The Secretary of the Treasury has indicated the dissatisfaction of that Department of the Government with the proposed new tax formula. We have attempted to point out to your committee some of the more significant features of the bill which in our judgment constitute basic defects. There are so many obvious inequities in the bill, resulting in part from the basic averaging concept upon which it is based and in part upon the effort to correct some, but not all of the problems resulting from that concept by providing for some companies' adjustments based on their individual methods of operation. There is an inadequacy of readily available data to test fully and precisely the effect of the many new and highly technical features of the bill upon and among the companies. There is no need for the haste that has characterized the legislative history of H. R. 7201.

Traditionally, the Congress in enacting tax laws has recognized the great economic, social, and moral values of life insurance. This special recognition is reflected in the provisions of the tax law relating to life-insurance proceeds received by policyholders and their beneficiaries and in the separate and special tax treatment that has been granted to the life-insurance companies. These privileges, in our opinion, cannot be justified unless all life-insurance companies are prepared fully to fulfill their tax obligations on a basis which is fair to the Government and which is fair and equitable as among the life-insurance companies. We believe that H. R. 7201 patently fails to accomplish these two objectives. We ask that it not receive the approval of your committee.

JULY 7, 1955.

Hon. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: I attach a copy of the letter which we originally had intended to send to you on the proposed bill on taxation of life-insurance companies. Since the letter was prepared, the bill has been limited to 1 year only and I have discussed it with Mr. Mills and Mr. Curtis who assure me of their concurrence with our view that the whole problem should have further study, and that further legislation should be developed for enactment next year.

Since the bill contains substantial improvements over the law in effect last

year, and since the suggestions embodied in the attached letter will have your careful study in connection with next year's legislation we withdraw our objection to H. R. 7201 and 7202 and approve its enactment.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

JULY 7, 1955.

Hon. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: I regret that the Treasury Department cannot unqualifiedly endorse H. R. 7201, which provides a new method for the taxation of life-insurance companies, even though it will be effective only for the years 1955 and 1956.

The bill would make desirable improvements in the definition of income. It would limit abuses by investment companies which do a small amount of insurance business, and by certain casualty companies which inflate their life-insurance business by means of policy loans, to qualify for favorable tax treatment. The bill would be fairer than the present law because it would treat the group annuity business of the life-insurance companies more like tax-exempt qualified pension trusts with which they compete. It also properly would eliminate duplication of the 85-percent intercorporate dividend credit and the proposed 85 and other percentage credits for reserve and other policy interest. The proposed segregation and separate taxation of their cancelable health and accident business, on a basis comparable to mutual fire and casualty companies in the same line of business, seems sound, though the wisdom of not taxing substantial amounts of the profits of some of the companies should have further study.

However, the proposed exclusion from the tax base of a flat 85 percent of investment income for ordinary life-insurance business does not appear to be justified. The resulting tax currently seems inadequate.

Our estimates indicate that, on the basis of present earnings and contracts with policyholders, the life-insurance companies will need only slightly over 75 percent of their 1955 investment income to meet their required reserve and policy interest, as compared with the 85-percent allowance in the bill. On these facts, it does not seem fair to the Government to adopt a formula which will permit the companies to go untaxed on investment income which is not needed under their contracts with their own policyholders. The total annual investment income of life-insurance companies now exceeds $3 billion. The corporate tax on almost 10 percent of that total is a very large sum.

Since 1921, life-insurance companies have been taxed only on their "free investment income," that is, their investment income in excess of the amounts they were committed or required to set aside as reserves under their policy contracts. Their income from other sources has gone untaxed.

The 1942 law assumed that the companies would be required to earn 3¼ percent on a major part of their investments to meet their policy requirements, and determined their taxable free investment income on that assumption. As the companies wrote policies on the basis of lower interest rates, this high assumption of required earnings was so unrealistic that the companies would not have been required to pay any tax at all for several years, even though they actually had very substantial investment income over their contractual needs.

In 1950, a taxing method was adopted under which the tax was based on the actual free investment income for each year. Though probably not ideal (other income continued untaxed; the individual companies were taxed on an industry average of their investment income), this method at least provided a logical basis for taxation. The life-insurance industry accepted this method, and even urged its adoption on a long-range basis.

In 1951, the policy requirements were about 87½ percent of actual earnings, which left a free investment income of 12½ percent. The 52 percent corporate tax on 12½ percent of earnings was about equal to 6½ percent on the entire investment income. A 6½-percent tax was imposed on all investment income, and was successively extended through 1954. This taxing method had no logical basis of its own, other than as a shortcut method of computation.

In the years since 1951, the companies actual free investment income has increased steadily. It is estimated that for 1955 they need only 75.5 percent of their investment income to meet their policy requirements. If determined in the same way as was done in 1951, the comparable tax rate on all investment income would have to be almost doubled (increased to 12.7 percent) in 1955.

The Treasury Department has reviewed carefully the history and problems of taxation of life-insurance companies. The valuable material in the hearings and the staff studies of the subcommittee of the Ways and Means Committee, published last year and earlier this year, has been examined. On the basis of our review and examination, I suggest that an attempt be made to develop a method of taxing life-insurance companies like other business on the basis of their entire income from all sources, with appropriate deductions for their expenses and additions to their reserves against their policy contracts. The reliance on free investment income alone ignores income and losses from mortality experience, the relation between loading charges and operating costs, and capital gains—which may be quite substantial.

Life-insurance companies were taxed like other corporations on the basis of their entire net income until 1921, when the tax base was confined to free-investment income. At that time, income taxation was still so new and undeveloped that it was found to be extremely difficult to deal adequately with the specialized problems of the life-insurance industry. Substantial advances have been made since that time in tax administration, and the methods and techniques of income measurement. It should now be possible to develop a fairer basis for taxation which will include all of the income and deduction items which properly reflect the earnings position of a life-insurance company.

The development of a satisfactory formula for taxing insurance companies on a comprehensive concept of income will take time. In the meantime, the 1950 formula (taxation of actual free-investment income) gives a logcial standard for measuring free-investment income and the industries' capacity to pay. We estimate that this formula would produce revenue of $368 million for this year, as against $189 million under the 6½-percent rate in effect from 1951 through 1954, and $215 million under H. R. 7201. In the absence of any legislation this year, the 1942 formula will become applicable again and produce revenue estimated at $274 million, as compared to $215 million under H. R. 7201 and $368 million under the 1950 formula.

The Treasury is impressed with the need for a fair and sound approach to the taxation of life-insurance companies. A satisfactory solution must recognize the special situation of the life-insurance industry and its responsibilities to policyholders. At the same time, it should impose a tax which is fairly distributed among the companies and fair in relation to the tax burdens of other savings institutions and taxpayers generally.

I and the Treasury Department staffs will be glad to be of such assistance as we can to your committee and staffs in any further examination of this subject which you choose to undertake.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

The CHAIRMAN. Senator Kerr, do you have any questions?

Senator KERR. On page 5 of your statement, beginning with the 8th line down from the top of the page, you have the statement:

> Our calculations indicate that of 20 companies so tested to date on the basis of their 1954 operating results, 3 of the largest would have paid less tax under the proposed formula than under the 6.5-percent formula. The remaining 17 companies so tested apparently would have paid between 108 and 120 percent of the tax actually payable by them for the year 1954 under the 6.5-percent formula.

Is that not true generally of all of the companies in the business, Mr. Schmuck?

Mr. SCHMUCK. That they would pay less?

Senator KERR. That the larger the company the more comparative advantage it would have under H. R. 7201 than it would have even under the continuation of the present law?

Mr. SCHMUCK. Generally speaking, I think of course the larger companies will derive the greater advantage from this bill. Some of the very small, the brand-new companies might have an advantage, although the limitations in H. R. 7201 are designed to eliminate the advantage that those new companies would get.

I think in general I would say "Yes" to your question.

Senator KERR. Is it not a fact that some of the very largest companies—and I think this is merely repetitious—would actually pay less taxes in 1955 than they did in 1954, in spite of the fact that they had substantially greater net income?

Mr. SCHMUCK. That, Senator, would have to be a guess, because, of course we do not have any 1955 results.

May I answer your question with respect to 1954, Senator?

Senator KERR. Yes.

Mr. SCHMUCK. That on the basis of the operating data that we have been able to compile and the calculations which are in part estimates we believe that among 20 of the largest companies doing business in the District of Columbia, 3 would have paid less in income taxes for 1954 under the formula of H. R. 7201 than they paid under the 6.5-percent formula.

Senator KERR. The general trend of the whole industry is of greater business and greater net, rather than less, is it not?

Mr. SCHMUCK. Yes, sir.

Senator KERR. So that generally speaking the advantage would be more pronounced under H. R. 7201 in 1955 than it would in 1954 had it been applicable?

Mr. SCHMUCK. I think it might work that way, sir; except for the fact that the relative rate under the formula of H. R. 7201—the basic rate—would be 7.8 percent of net investment income, as compared with 6.5 percent under the formula that was in effect for 1954.

So you start out with the fact that the basic rate——

Senator KERR. Is larger.

Mr. SCHMUCK. Is larger, yes, sir; under H. R. 7201, but——

Senator KERR. But the exemptions are new and create widely different results?

Mr. SCHMUCK. That is correct, sir. And I believe they are results that with currently available data, at least, cannot be predicted with precision.

Senator KERR. There has been evidence before this committee which caused one member of it—and I am sorry that he is not here to appear to get the impression—that there has been an increasing conservatism on the part of most insurance companies in the operation of their business and that under certian suggested situations the least conservative would be the more favored. Without taking issue with that apparent conclusion of the member of the committee I would like to ask you a question or two.

The required interest under the State insurance laws—I am not sure, maybe under the Federal Government—I do not know about that—on reserves has been gradually reducing over the past few years with reference to all of the insurance companies; has it not?

Mr. SCHMUCK. With reference to the industry as a whole, and I believe with reference to every insurance company; yes, sir.

Senator KERR. Is it not a fact that a few years ago that figure was about 3.75 percent?

Mr. SCHMUCK. I have the figures here, Senator, running back to 1947. At that time it was 3 percent. Prior to that then it would have been somewhere between 3 and 3.5, I would say.

Senator KERR. In somebody's testimony here—I am not sure, but what it was Senator Lucas or Mr. Williams—it might have been yours—the figure of 3.75 percent was used. I thought it was indicated that that was the figure applicable prior to 1947.

Mr. SCHMUCK. I think, sir, that may have been in the Treasury's letter, and was the arbitrary 3.75 percent deduction that was allowed under the 1932 tax law. No, it is not there. That was the rate of deduction that was allowed under the 1932 tax law. But that was a strictly arbitrary figure that was used for purposes of the tax law.

Senator KERR. What was the required rate applicable to reserves in 1947?

Mr. SCHMUCK. In 1947, according to the industry report that I have before me, the required rate was exactly 3 percent.

Senator KERR. What was the highest figure that it had been, in, say, the 10 years previously?

Mr. SCHMUCK. We do not have the figures, Senator, but it would have been somewhere between 3 and 3.5.

Senator KERR. Probably at times 3.5?

Mr. SCHMUCK. I would think probably below 3.5—more in the neighborhood of 3.25.

Senator KERR. What is it now?

Mr. SCHMUCK. Again it is the last figure that I have, for the year 1953. At that time it was 2.859 percent.

Senator KERR. The fact that the company uses 2.85 or 2.75, if permitted under the law of the State or required under the law of the State, instead of 3 percent as was the case in 1947, or up to 3.25 or above prior to that time, is it not because of the company being more conservative or less conservative in its operations, but by reason of the workings of the economics of our country and the requirements of law and the prevailing interest rate, is it not?

Mr. SCHMUCK. Well, that certainly is an important part of the decision, Senator. It is a decision which is based in large measure upon the estimate of the company which is directly a reflection of the economic situation as to what it is going to be able to earn on its investment, coupled with the projection by the actuary, and I think Mr. Crippen should be answering this question—coupled with the projection by the actuary which in part is based on his assumption that a guaranteed rate of interest will bear a reasonable relationship to the company's ability to earn interest.

In general since about 1947 or 1948 I think most of the companies of the country have been on a 2.5 percent guaranteed interest base. Some companies have been as low as 2 percent. There are a few which are higher than 2.5 percent. Those that are higher, by and large are the smaller and the newer companies.

Senator KERR. The blue chip group—that group with reference to whom conservatism is more or less equal. That figure has ranged from 2 to 2.5 percent?

Mr. SCHMUCK. Yes, sir. Generally, in the neighborhood of 2.5 percent.

Senator KERR. Is is not a fact that during this period of time the required interest rate has been getting less and less?

Mr. SCHMUCK. Yes, sir.

Senator KERR. And the actual interest income has been getting more and more?

Mr. SCHMUCK. Yes, sir.

Senator KERR. And on an increasing amount of investable funds?

Mr. SCHMUCK. That is correct, sir.

Senator KERR. And that is the reason for the fact principally, or certainly substantially, that you were able to say or brought to say here on page 3, in the second paragraph:

Thus, in view of the trends which are producing a steady decrease in the percentage of investment income needed for reserve and other policyholder obligations, the proposed formula will have the result of taxing, in the predictable future, a steadily decreasing percentage of the aggregate free interest of the companies.

Mr. SCHMUCK. That is correct, sir.

Senator KERR. The fact is that the free interest is progressively increasing, both for the industry and the representative company year by year?

Mr. SCHMUCK. Certainly, for the industry, sir. And for every company that I know about.

Senator KERR. My statement was a representative company.

Mr. SCHMUCK. A representative company, yes, sir.

Senator KERR. Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Schmuck.

Mr. SCHMUCK. Thank you.

The CHAIRMAN. Our next witness is Mr. Robert L. Hogg, of the Equitable Life Assurance Society of the United States. We are very glad to have you here, sir. You may proceed.

STATEMENT OF ROBERT L. HOGG, SENIOR VICE PRESIDENT OF THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, APPEARING AS CHAIRMAN OF THE JOINT COMMITTEE ON FEDERAL INCOME TAXATION OF LIFE INSURANCE COMPANIES OF AMERICAN LIFE CONVENTION, LIFE INSURANCE ASSOCIATION OF AMERICA AND LIFE INSURERS CONFERENCE, AND ACCOMPANIED BY BRUCE E. SHEPHERD, MANAGER, AND EUGENE M. THORE, GENERAL COUNSEL, LIFE INSURANCE ASSOCIATION OF AMERICA, AND CLARIS ADAMS, EXECUTIVE VICE PRESIDENT, AND ALFRED N. GUERTIN, ACTUARY, AMERICAN LIFE CONVENTION

Mr. HOGG. Mr. Chairman and members of the committee, I am Robert L. Hogg, senior vice president of the Equitable Life Assurance Society of the United States. I am appearing as chairman of the joint committee on Federal income taxation of life insurance companies of the American Life Convention, Life Insurance Association of America, and the Life Insurers Conference. The combined membership of these three organizations holds approximately 99 percent of the legal reserve life insurance outstanding in the United States. We appear to endorse H. R. 7201. The printed transcript of the hearings before a subcommittee of the Ways and Means Committee contains detailed statements on behalf of our joint committee. And I assume the Senate Finance Committee would prefer to review that record rather than to receive a complete restatement of our views on the general aspects of life insurance company taxation at this time. We would, however, like to comment a little on the background of the proposal in view of the fact that there may be some inference that this comes to the Senate Finance Committee as ill-conceived legislation.

Since 1947 life-insurance company taxation—as my friends who have preceded me have indicated—has been in a state of uncertainty. The House Committee on Ways and Means in the early part of 1954 appointed a special subcommittee to develop a permanent tax formula. The subcommittee's staff prepared and circulated long in advance of hearings a comprehensive statement pertaining to all phases of the company tax problem. The statement gave the pros and cons of every tax formula that had been seriously considered and the report of the subcommittee hearings is so comprehensive that even up to the present time nothing has been advanced that is not found therein.

The subcommittee held conferences with interested groups, including State insurance commissioners, representatives of the life-insurance business, and others. On December 13, 14, and 15, 1954, formal hearings were held to afford every interested person an opportunity to present his ideas. From these conferences and hearings has come H. R. 7201, unanimously recommended by the full Ways and Means Committee and passed by the House, apparently without a dissenting vote.

The bill has back of it a record of study and deliberation. It is appropriate to note that the subcommittee developed its bill as a permanent tax formula although to satisfy current Treasury reservations it was decided to limit its application to a 1-year trial period. Aside from its subject matter the bill commends its own consideration by the orderly way in which it was developed.

There are certain basic principles which we feel are worthy of comment.

The record shows that while the bill reflects recommendations made at the hearings, it is basically the subcommittee's own product. Some of the principles advanced by our own joint committee were accepted while others were rejected. The bill recognizes these three well-accepted principles:

(*a*) Investment income is the only sound and practicable base for the income taxation of life-insurance companies.

(*b*) Due recognition must be given to the fact that certain of the investment income must be used to maintain reserves.

(*c*) Stock and mutual companies must be taxed on the same basis.

Taking up the first point:

(*a*) The bill recognizes investment income as the only sound and practical base for the income taxation of life-insurance companies.

For more than 30 years investment income has been recognized as the sole basis for a Federal income tax on life insurance. The reasons for this are twofold. First, life insurance is a long-term business. On this point the report accompanying the present bill says—

> the annual accounting period which is applied to business in general is not a suitable measure of income for issuing life insurance contracts which by their nature may span many decades.

Therefore, life-insurance companies are not susceptible to an annual profit and loss treatment for tax purposes as in the case of ordinary corporations.

Second, approximately three-fourths of all life insurance assets are held by mutual companies. We may assume that the mutual companies receive the same percentage of total investment income. In analyzing the tax situation therefore, we should start from the

position of the mutual company, because three-fourths of the investment income is derived from that source.

In the case of mutual life-insurance companies, investment income is their only true corporate income. The only other source of revenue is from premiums paid by policyholders which are in the nature of capital contributions to a common fund through which policyholders share mortality losses and the expenses of a cooperative nonprofit enterprise. Such premiums are calculated by a long-term projection of probable mortality experience, interest earnings and an estimate of the expenses of operation over a long period of years.

Since mutual companies have no independent capital, these estimates are necessarily conservative in order to provide for possible fluctuations in the death rate, interest earnings and the expense level. The excess in the premiums represented by the margins, if any, between estimates and actual experience is returned to the policyholders in the form of so-called dividends.

These do not represent a profit in any sense. They are merely the policyholder's own money coming back to him as the return on an unused portion of a capital contribution to a cooperative fund. This principle was analyzed and approved by the Supreme Court of the United States in *Penn Mutual* v. *Lederer* (252 U. S. 523, 231).

Now we come to the important point which has been the subject of quite a bit of colloquy with the preceding witnesses, because it is an important part of any tax proposal.

(*b*) The bill gives recognition to reserve requirements of the business. Life-insurance companies are required by laws of the several States to set up reserves against future liabilities. The necessity for such reserves grows out of the level premium plan whereby the policyholder pays a constant premium until the maturity of the policy although the death rate increases with age. The premiums paid by a group of policyholders of a given age result in a substantial margin of income over disbursement in the early policy years and a corresponding deficit in later years.

Therefore it is necessary for the company to reserve margins in the early years to meet the inevitable deficits of later years in order to be able to discharge their obligations to all policyholders upon the maturity of their contracts.

These legal reserves are calculated actuarially. Here let me digress to say that I am accompanied, Mr. Chairman, by Mr. Claris Adams, executive vice president, and general counsel of the American Life Convention, and the actuary, Mr. Guertin of the American Life Convention, and Mr. Bruce E. Shepherd, manager, Life Insurance Convention of America, and also by Mr. Eugene M. Thoré, general counsel of the Life Insurance Association of America.

In connection with these actuarial problems, in connection with the questioning, if I feel incompetent to answer some of them, I would like to refer them to these gentlemen. Taking up wherè I left off. Legal reserves are calculated actuarily and at any given time are that amount which assuming future mortality as a given rate—and I will read slowly because it is a rather important sentence—and the investment of the reserves at an assumed rate of interest will, together with future premiums payable, in the judgment of management—I want to underscore that, "in the judgment of management"—meet all policy obligations of the company as they occur.

These reserves must be improved year by year by the addition of interest earnings at an assumed rate on that portion of the assets equivalent to these reserves in order to be adequate to meet policy obligations at maturity. The taxation of all interest income without recognition of these requirements would necessarily jeopardize the reserves themselves and thereafter the solvency of the companies.

However, the various State laws under which life-insurance companies operate establish a minimum standard for such reserves.

I would like to point out that these statutes prescribe minimum reserves which any company can use.

In many cases the company has a choice between recognized standards for determining reserves, but not one more liberal than the standard specified in the law. In all States the interest rate assumed on the investment of reserve funds in a matter left to the discretion of the management except again that it cannot assume a higher rate of interest than that specified in the statute.

The higher the interest rate assumed on the investment return, the lower the reserve will be. It is apparent that it takes a larger sum of money improved at an interest rate of 2½ percent to accumulate a certain fund at a given time than if it were accumulated at 3½ percent for the same period.

Therefore the company which assumes the lower rate of interest puts up a higher reserve against the same ultimate liability. Obviously it would be unfair to penalize a company taxwise simply because it sets up higher reserves against the same liabilities than competing companies do.

Therefore, since 1942 all life insurance company income-tax laws have granted all companies the same "reserve and other policy liability deduction" as a percentage of investment income. This equality of treatment is so clearly fair and the necessity thereof is so well understood that it is almost unanimously accepted in the business.

Now as to the matter of the taxation of stock and mutual companies. That has not been touched upon by the preceding witnesses.

(C) Stock and mutual companies taxes alike. The bill applies the same tax formula to both stock and mutual life insurance companies. Life insurance is unique in this respect. The mutuals, though much fewer in number, dominate the market. They have three-fourths of total assets of the entire business. Since there is no more fiercely competitive market in America than that of life insurance selling, it is obvious that any significant differential in taxes between stock and mutual companies might drive some stock companies out of business. Practically all companies, both stock and mutual, with the single exception of the company appearing here today, have always supported the proposition that both types of companies should be taxed in the same way.

Because equal treatment is necessary to preserve a competitive balance, the mutuals have never asked for a tax advantage in a field which they already dominate. Doubtless this mature conviction within the business that equity demands the tax base should be the same for both classes of companies has at least been influential in maintaining tax equality in this field.

Now some of the new features of this proposal:

The proposed plan contains many new features not heretofore found in any tax measure. We particularly refer to—

(*a*) Redefinition of gross income.

(*b*) Safeguard against tax avoidance.

(*c*) The application of the corporate rates to a reduced base as compared with a low rate tax on a higher base.

(*d*) Readjustment in the taxation of the accident and health operations of life companies.

(*e*) Readjustment of method of establishment of taxable income.

(*a*) The definition of gross income has been expanded. Since Congress originally defined "gross income" as being "interest, dividends, and rents," other sources of income have appeared. For example, some companies receive oil royalties in connection with foreclosed real estate. These royalties, under court decisions are not "interest, dividends, or rents."

Again a payment to a life insurance company as a consideration for an option for a loan to be made at a future date is not interest. The new proposal would reach such income.

(*b*) The bill contains new provisions to prevent tax avoidance through overcapitalizing a life insurance company. A ceiling is placed on the 85-percent deduction allowed against investment income arising from regular life-insurance business.

I will discuss this further, this 85-percent figure, which Senator Kerr mentioned a while ago.

If such investment income exceeds 200 percent of interest required, the excess is taxed at the full corporate rate.

Unlike the formulas applicable to the business years since 1947, the new proposal is geared to the corporate rates. Recent life insurance tax laws have been on a flat rate applied to substantially the gross income of the business. This rate was much lower than the general corporate rates. Many people were uninformed as to the fact that this lower rate was applied to gross income instead of net income, as in the case of corporations generally.

Erroneously, they were inclined to think that because the business was taxed at a rate less than the general corporate rate, the life insurance business enjoyed some tax advantage. The current bill eliminates this confusion by gearing the new law to the general corporate rates. Our committee feels that this is a desired improvement. Not only from the standpoint of the companies, but from the standpoint of the Government.

Briefly, the new law instead of putting a flat tax upon total net investment income would apply the corporate rates to the next investment income after certain deductions applicable to particular lines of business.

(*d*) In previous tax laws, the method of taxing the income arising from the cancellable accident and health operations of life insurance companies has been on an artificial basis, not altogether satisfactory to the Treasury. This has not been mentioned previously by the preceding witnesses.

The present proposal would tax all of the accident and health operations of life insurance companies on the same basis as such accident and health business would be taxed if transacted by a mutual

casualty company. This materially increases the taxes of practically all life insurance companies doing an accident and health business.

(*e*) The present proposal uses a more appropriate method for arriving at the amount of deductions from net income to establish the amount of such income that is to be taxed.

This is the crux of the discussion which preceded my statement.

For the first time, consideration is given to the various lines of life insurance business. Instead of taking a single deduction relating to all lines of a company's business, there will be the following three separate deductions, each covering a different line of operation:

(1) Investment income attributable to funds held for approved pension plan purposes.

That has previously been discussed.

(2) Investment income attributable to individual annuity contracts, settlement options and kindred categories.

(3) Investment income attributable to regular insurance operations.

And now a word as to these approved pension plans.

There would be a complete exemption of that portion of investment income based on the ratio of pension fund reserves to total assets. This means that earnings on that portion of the surplus allocable to these funds continue to be taxed. While the wisdom of taxing earnings on such surplus may be questioned, the point is not stressed at this time.

The reason for this 100 percent deduction is simple. A trust established by a bank or trust company for approved pension plan purposes is completely exempt from Federal income taxes. This exemption has given to the banks and trust companies a very great competitive advantage over life insurance companies furnishing this same service.

At this point, I would like to direct your attention to the very extensive evidence in the hearings before the Ways and Means Subcommittee on that point. Judge J. Raymond Tiffany appeared on behalf of the Association of Small Businessmen, specifically pointing out what it means to the small-business man competitively not to be able to resort to a trusteed plan as compared to his larger competitor because of the fact that he has obviously not enough employees to justify a trust for that purpose. The record is very complete on that point.

Individual annuities, settlement options and kindred categories: From the income allocable to these types of operation, there would be a deduction of 95 percent. As to this deduction, the Ways and Means Committee report aptly says:

> This deduction is designed to reflect the fact that this interest is taxable, in general, when received by individuals. In this sense it differs from interest added to life-insurance policy reserves which is regarded as not taxed to individuals. Some taxation at the insurance company level on the annuity earnings is justified because the individual tax on the interest is, technically, long postponed.

These percentage figures which I have used in connection with the 100 percent deduction and the 95 percent deduction represent the ultimate objective of the bill in grading it into a 1-year application. There has been accordingly an adjustment in those two figures, but that is the philosophy of the bill, and I approach it in my statement on that basis.

Regular insurance operations: The major deduction is the 85 percent of net investment income allocable to the strictly life-insurance business. As to this deduction, the Ways and Means Committee report says:

> The bill provides a deduction of 85 percent of the net investment income allocable to the regular life-insurance business. The stop-gap tax imposed on life-insurance companies from 1951 to 1954 was equivalent to regular corporate rates applied to net investment income after an 87½ percent deduction.
>
> On the basis of reserves presently stated on the company books, the industry currently needs less than 85 percent of its net investment income to fulfill policy obligations. This smaller current interest requirement is due in part to the fact that in recent years the companies have transferred considerable amounts of surplus to reserves in a process known as reserve strengthening.
>
> While this does reduce the current need for interest additions to reserves, it does not appear desirable that tax liability should depend on pure bookkeeping changes. Moreover, the ratio of interest requirements to current interest earnings will vary considerably over time because of the slow adjustment of reserve interest patterns to changing interest rates. It also does not appear desirable that tax liability should depend on these year-to-year variations in the reserve interest picture.

The reserve strengthening referred to in the committee report came about in the following manner. Prior to the sharp decline in interest rates which followed the depression and continued progressively through the war period, practically all companies of the United States put up reserves on either a 3 percent or a 3½ percent basis.

As the earned interest rate declined, many companies were currently earning less than 3 percent on their accumulated funds. Therefore, many of the companies changed their interest assumptions retroactively as well as prospectively by so strengthening their reserves that those which had formerly been calculated on a 3 percent or 3½ percent basis were increased to a 2¾ percent or a 2½ percent level.

This reserve strengthening has had the technical effect of lowering interest requirements. For instance in 1942, the average reserve interest requirement of all companies was 3.25 percent. In 1953 it was approximately 2.84 percent. However, in 1942 the interest actually earned was 3.44 percent and in 1953 it was 3.46 percent, with very little change in rate.

The net rate of interest earned was practically the same in each of these years and essentially the policy organizations of the companies were the same. The only difference in the circumstances of the companies was that some companies had strengthened their reserves against equal liabilities. On the other hand, if all companies should put up the minimum reserves allowed by law (which was underscored a little while ago) by the assumption of a 3½ percent future interest return on invested funds, there would be practically no margin at all between interest required to maintain reserves and interest actually earned on invested assets.

It was recognized by the House Ways and Means Committee that a tax program which would give tremendous tax incentive to the companies to maintain the weakest reserve structure permitted by law was not in the public interest. Therefore, the Ways and Means Committee concluded that the 85 percent deduction which represents approximately an average for all companies over a period of years was the soundest and fairest basis of deduction.

A few more words as to the deduction of 85 percent of corporate dividends.

The new plan would make a most important change in a long-established method of determining net investment income. One of the deductions allowed to all corporations, including insurance companies, in determining taxable income has been the deduction of 85 percent of corporate dividends received. During the course of the subcommittee's consideration of the life-insurance company tax problem, the question arose as to the advisability of their continued right to receive these deductions. Pursuant to an opportunity afforded by the subcommittee, representatives of our joint committee appeared in support of the continuance of the deduction.

Nonetheless, the subcommittee recommended that the continued right to deduction should be eliminated in the new bill. This would result in a substantial increase in taxes for several companies.

Relief for smaller and newer companies: Among the principles advocated by our joint committee but which were not accepted by the Ways and Means Committee was one that would give tax relief to the newer and smaller companies. Specifically we urged that any life-insurance company whose income tax was $100,000 or less should have a reduction in its tax. There would, however, be a 50-percent limit to the amount of this reduction.

It was the unanimous view of our committee that for competitive reasons the newer and the small companies were entitled to this tax incentive. So far as we know no company opposes it. Incidentally, a preliminary estimate indicated that the tax loss to the Government would be quite insignificant. Our committee would like to see this incentive granted, if it could be done without jeopardizing favorable action on the bill itself.

The present proposal would definitely operate on a company-by-company basis. The company's own investment income would be the basis of its tax. Neither the income nor the deductions of an individual company would be controlled or affected by the experience of any other company. Consideration of the various factors which I have just mentioned prompts our joint committee unanimously to support the bill and urges favorable consideration by your committee.

The CHAIRMAN. Thank you very much, Mr. Hogg. Are there any questions, Senator Kerr?

Senator KERR. Yes. On page 7, at the top of the page——

Mr. HOGG. May I interrupt? The reason I referred to the actuarial aspects, I wanted to hedge a little bit—I do not want to be using the expression of "fringe of the periphery."

Senator KERR. You were here that day?

To quote from your statement on page 7:

> Unlike the formulae applicable to the business years since 1947, the new proposal is geared to the corporate rates.

That is at the top of page 7. I take it that that means that the corporate rates applicable to other corporations were made applicable to the insurance companies?

Mr. HOGG. That is after we had arrived at our taxable net income, yes, sir.

Senator KERR. Not after you had arrived at your actual taxable net income, but after you had arrived at a figure obtained by reducing your interest income by 85 percent.

Mr. HOGG. That is right, yes, sir, that is correct.

Senator KERR. That 85 percent figure is not realistic, is it, Mr. Hogg?

Mr. HOGG. Frankly, I think it is. If you would like for me to elaborate just a little bit on that, I would be glad to do so.

That represents an average over a long period of years.

Senator KERR. That represents an average over the years in which there was not an——

Mr. HOGG. No, I disagree with you. You referred to the 1950 formula.

Senator KERR. In 1946 and 1947, some of the witnesses have told us here that the insurance companies paid no taxes at all.

Mr. HOGG. In 1947, under the 1942 formula.

Senator KERR. That was a formula derived in part by the applicability of arbitrary percentages.

Mr. HOGG. In part two-thirds of it was fixed and one-third of it was the average of the business as a whole. That was averaging throughout the business, yes—yes, that is correct.

Senator KERR. So that unless you are assuming, or unless this Congress assumes that there will be future years in which there will be no net investment income, then the 85-percent figure is arbitrary and unrealistic.

Mr. HOGG. Let me put it in another way. This averaging through the business is not an averaging of the statutory requirements. If you put it on the basis of the statutory requirements, what the companies were actually required by law to put up, there would be scarcely ever any excess interest to be taxed. In place of that, what they have done, they have cast this formula on what the companies are actually using in the interest of conservatism, in other words, they increase their reserves, so that they are not required to earn the statutory rate of interest provided, but they can earn a lesser rate. And by reason of that conservative operation it leaves a greater gap. It is purely an arbitrational operation.

Senator KERR. And experience has demonstrated that it has greatly enriched the reserve funds.

Mr. HOGG. No, I would not say that. I do not agree with that. I will tell you why I do not agree with that.

Senator KERR. That is the only way I can interpret the figure.

Mr. HOGG. Let me explain it to you this way.

Senator KERR. I will be glad to have you do so.

Mr. HOGG. You start out with a block of policies, where you assume the 3.5 percent interest rate. By the way, I want to turn to my cohorts back here to bail me out if I get in too deep. You take 3.5 percent. Let us assume we have put up a block of policies at 3.5 percent. We find that we cannot make 3.5 percent or that we ought to revalue them at a lower rate of interest. What happens? We have to build up the amount of that reserve. Where do we get that reserve in a mutual company? We retain part of your premium to build up that reserve.

Senator KERR. But that has been done already, has it not?

Mr. HOGG. Manifestly, but it is an artificial proposition.

Senator KERR. But it is not artificial in that you have actually got the reserve, is it?

Mr. HOGG. We have got the reserve, we require less, but the point is that we should not be penalized for putting it on a more conservative basis.

Suppose we reversed the process as we could do in some States, although I am not sure it could be done in all States.

Senator KERR. Do not make a statement that you cannot do it in all States, unless you can back it up.

Mr. HOGG. I know you well. I will not. Let us assume that we start to reverse the process. You have got two assumptions, in the maintenance of reserves. It sounds like I am qualifying as an actuary. We have two assumptions in connection with these reserves.

You have mortality, and you have got an interest assumption. You can vary either one of them. You can assume a higher mortality and vary your interest rate.

Senator KERR. You mean assume——

Mr. HOGG. Assume that is right, or you can do—there are two elements in there which are variable and they are purely artificial, a bookkeeping approach to it. Yet the statute prescribes a minimum standard, and we have voluntarily in the interest of conservatism—and by the way, in which there is no dissent in the business—in the interest of conservatism, if we build up or have built up a bigger reserve, I cannot see in my own mind what is to prevent us if we are going to be penalized taxwise, what is to prevent us from trying to reduce that liability by reversing the valuation process.

Senator KERR. You would not resort to a procedure that in your judgment would jeopardize the integrity of your commitments, to save a little tax?

Mr. HOGG. Not at all—not at all.

Senator KERR. Let us not speculate upon an eventuality which neither of us contemplated.

Mr. HOGG. I think that you could take the same thing—in case of carrying it as a reserve liability, carry it as a surplus. Many companies instead of strengthening reserve, in place of strengthening the reserves, carry an increase in surplus.

In strengthening these reserves, what you have done is that you have taken amounts of surplus and added them to reserves.

Senator KERR. And everything you say it seems it verifies or reinforces my premise, that is, that your taxation is not on a realistic basis, but on a basis which develops by reason of the indulgment in fictions.

Mr. HOGG. With great respect to your conclusion about this——

Senator KERR. Well, you see yourself that over a period of years they went beyond the requirements of the statute and enriched the reserves; others enriched the surplus. As I understand it, it might be that that has some relationship to what you thought was needed to protect the policyholders, but I have gathered that there might have been the factor in there that it was prompted by reason of the tax structure.

Mr. HOGG. No, no, not at all.

Senator KERR. That impression is not justified from what you say?

Mr. HOGG. Perhaps I do not make myself clearly understood in that area. For the first time, I think since 1942 the Government has put the business in a position where it can penalize it—probably has penalized it for conservatism.

Up to 1942 the Government put a premium upon conservatism, because it related the tax, a flat tax, to its reserve requirements; in other words, through higher reserves there was possibility of a lower tax. I am not saying this was employed, but I am saying it does

clash with the present philosophy which results in an increase of tax liability through practice of conservatism in the maintenance of reserves. Let me give you an example of what we have run into here in recent years in connection with this.

Here is one of the difficulties that we encounter in the averaging process. A large company, say, revalues its outstanding obligations. It has got a big total percentage of the business. It revalues its obligations and increases all its reserves. The result is under the formula to a certain extent in 1942 more so in the 1950 formula, it will increase the tax base, the tax rate for every other company—whether it does or not change its own reserve basis—there was a tremendous reaction to that.

Senator KERR. I can understand that.

Mr. HOGG. So we came back.

Senator KERR. A sort of reflex action?

Mr. HOGG. That is right. And we come back now—I just had these figures here—it will illustrate my point that I do not think that the 85 percent is unrealistic. Just go back to 1950, when it came into effect, that 1950 act, the figure is 90.63——

Senator KERR. All right. You have enriched the reserves since then.

Mr. HOGG. Yes, partially, but it was also due to the fact that they had been increased prior to that time. The peculiar mechanism of it is that it does not wear out completely the year in which the reserves are increased.

Senator KERR. Regardless of that, the reserves have been greatly enriched since 1950.

Mr. HOGG. I would not say they were enriched. The policyholders put up more of their money.

Senator KERR. And it has resulted in the enrichment of the reserves or the reenforcement.

Mr. HOGG. They will get the benefits of it eventually; that is true.

Senator KERR. They have been reenforced and enriched.

Mr. HOGG. Yes.

Senator KERR. Yet in spite of that fact it required what percent in 1950?

Mr. HOGG. It required 90 percent. Just taking it from the last ideas—take it from 1950, it took 90.63. These figures are just hastily put together here. Mr. Stam will have these figures, I am sure. This memorandum shows in 1950, 90.63.

Senator KERR. That is 90.63 percent?

Mr. HOGG. Deduction.

Senator KERR. Of the annual free investment income to meet your——

Mr. HOGG. Reserve and other policy liabilities.

Senator KERR. Let us go forward on that basis, year by year. What was the percent required in 1951?

Mr. HOGG. The percent required in 1951 was 87.88.

Senator KERR. And in 1952?

Mr. HOGG. It was 85.87.

Senator KERR. And in 1953?

Mr. HOGG. It was 81.71.

Senator KERR. And in 1954?

Mr. HOGG. 78.81. That makes——

Senator KERR. Where did these figures come from that have been floating around here, 75.5 percent that Mr. Williams of the Treasury Department gave us?

Mr. HOGG. I think it is 73 or 78.

Senator KERR. Mr. Williams' figure of 1954 was 75.5 percent.

Mr. HOGG. It may be that these have been pulled together here too rapidly, in just a rather informal way.

Senator KERR. I do not care how informal they are. I know that neither you nor I want your statement to be inaccurate, and I hope they will not be.

Mr. HOGG. Mr. Chairman, let me supply for the record the particular figures which are needed.

Senator KERR. What is your estimate for 1955 on that piece of paper you have in your hand?

Mr. HOGG. Mr. Adams thinks probably it is in the committee report here. I do not have them.

Senator KERR. What both you and I are interested in is in accuracy, is it not?

Mr. HOGG. Yes. I do not have the 1955 figures. I have no reason to doubt Mr. Williams' figures at all. I have no reason to doubt them.

Senator KERR. You heard him say the figure for 1954 was 75.5.

Mr. HOGG. Mr. Guertin says that for 1955 it is 76, is that it? That is our figure, but not enough variance.

Senator KERR. Yours is?

Mr. HOGG. It would be about 76.

Senator KERR. Here is what I would like for you to tell the committee. If the experience based on your figures there has seen a reduction in the requirements steadily from 88 in 1951 to 76.76 in 1955, or to 72.6 as indicated by Mr. Williams, how can you arrive at any conclusion other than that 85 percent is unrealistic?

Mr. HOGG. Well, because it is an average one, the average even for the last 4 years, for example is 84.92. For just 5 years excluding 1955, 1950 to 1954, it will average 84.92.

Senator KERR. Do you know any other taxpayer that gets the benefits of a liability based on an average of the 20 years past, regardless of how little application that has to the realities of the current year?

Mr. HOGG. I would not say that it would be arbitrary. I know that the depletion allowances on oil and gas and coal operate in much the same way.

Senator KERR. As the dollar income changes, the figures change, too.

Mr. HOGG. And the value of our product changes with inflation, too.

Senator KERR. While it does, the feature to which the tax is applicable does not, because you are still paying any year in which experience, according to Mr. Williams, is 75.5. You still are paying taxes on the basis of 87.88.

Mr. HOGG. Let me carry you a little bit back further. I am sure that the deduction I mentioned a while ago was not arrived at then on the basis of 4 years' experience. It is unfair to take 4 or 5 years. Let me show you what happened in 1947. It was 100 percent.

There is no reason why we should take the last 4 years, when you go back ot 1942, and probably get a lot less than 85 percent.

Senator KERR. What about applying the same rate of taxation to your actual net income, rather than to an arbitrary figure, regardless of how it may be derived?

Mr. HOGG. That is exactly what the stopgap 6.5 percent formula did. That is exactly what it did.

Senator KERR. Mr. Hogg, you are the only witness that has been here who has intimated that, I want to tell you that. I do not believe you will find a man on the committee that will accept that.

Mr. HOGG. As I understood you, you asked me why we did not apply a rate.

Senator KERR. I asked you why not apply the regular percentage of taxation applicable to corporations to whatever your actual net income may be for 1955.

Mr. HOGG. You mean on an individual company basis?

Senator KERR. Yes.

Mr. HOGG. That raises the whole point, Senator, that if you put it on an individual company basis, and put it as Mr. Schmuck has suggested on an individual company basis, its own reserve requirements, you assume yours, eventually you could not have any tax. I refer to what Secretary Snyder said in 1950 when he discussed this thing. He made the statement, and he is correct about it—he said, "If you put it on that basis," and he used this expression, you may "Assume away any tax liability."

That is exactly what would happen.

Senator KERR. Then that is in direct conflict with what Secretary Humphrey says.

Mr. HOGG. No, I do not think so. I do not agree with you that it is.

Senator KERR. Here is what he said:

> The reliance on free-investment income alone ignores income and losses from mortality experience, the relation between loading charges and operating costs and capital gains—which may be quite substantial.

Mr. HOGG. Let me tell you what else he said in there. I am sure it is implicit in there. It has been in all of the other presentations. That as a mutual company you must be permitted to two things; to deduct your dividends to policyholders and reasonable additions to reserves. When you finally carry that to the end of the road you have not any tax in the mutual company.

Senator KERR. You take the position that the same tax figures should apply to both?

Mr. HOGG. Yes, for competitive reasons, yes.

Senator KERR. You told us that your association endorses H. R. 7201?

Mr. HOGG. Our joint committee endorses it; yes.

I recall your question of Mr. Williams, I think it was, that you would be interested in the machinery that we have gone through probably to prompt that statement. We have circulated the bill. We have circulated all of the testimony which was introduced before the Ways and Means Committee. We have given every opportunity to every company to come in and make an appearance. And we have not gotten from any company an objection to this bill. On the strength of that, I think I could say that that is the unanimous endorsement of the business with the exception of Acacia.

Senator KERR. You are basing that conclusion upon the fact that you have not had any specific criticism?

Mr. HOGG. Well, that, partly. We had a meeting of all companies, both members of these three organizations, and nonmembers. We invited all of the life-insurance companies of the United States to meet in Chicago last summer.

Senator KERR. And they all said they would like to have it?

Mr. HOGG. Not this bill. They all came. We made a very substantial record in connection with that.

Senator KERR. Have you polled the members on this bill?

Mr. HOGG. Not on this bill. We circulated the bill, but we have not polled the members, that is right, but the bill has been circulated, widely advertised through all of the trade journals, thoroughly and completely explained, so if there is anybody that does not know about this bill and what it does, I do not know.

I want to add one thing. The suggestion was made by Senator Lucas that we just shove it up to 7.5 percent, and let the thing go. The impact of that would be tremendous. There would be a tremendous difference throughout the entire business on that proposal, because that 7.5 percent represents a 20 percent increase with the exception of these allowances that were made for the pension plan setup.

I would like to point this out, this is not a new matter.

Senator KERR. Wait a minute. You have made a statement there that the other information I have does not support, that is, that an increase from 6.5 to 7.5 percent, and a continuation of the present law would bring about a 20 percent increase in the applicable tax rate.

Mr. HOGG. That would be—would it not be about 6.5?

Senator KERR. You have actuaries here.

Mr. HOGG. Let me say this, that this bill, the present bill increases basically the rate 20 percent, because——

Senator KERR. Let us stay on one subject at a time.

Mr. HOGG. All right.

Senator KERR. Which actuary is going to substantiate that statement for you?

Mr. HOGG. The increase from 6.5 to 7.5 percent would represent what percentage increase in the basic rate?

Mr. SHEPHERD. About 14 percent.

Mr. HOGG. I will bank on that.

Senator KERR. But you would not bank on the 20 percent?

Mr. HOGG. I will bank on the 20 percent in the bill. What I meant to say is that the basic increase in this bill is about 20 percent. If you put the corporate rate at 52 prrcent on the life-insurance operations, on the part to which the 85 percent applies, which is the regular life-insurance business, the increase on the corporate rate of 52 percent on that represents an effective rate of 7.8, I understand, but now, of course, you are excluding from that the income attributable to the pension plan funds.

Senator KERR. You are excluding from that the income on mortality tables and capital gains.

Mr. HOGG. That is not taken into account, that is correct.

Senator KERR. In what year or years did most of the life-insurance companies start to issue new contracts providing for a lower reserve interest rate?

Mr. HOGG. I would like to refer that question to the man who wrote the standard, Mr. Guertin, I think, some time after about 1948. Is that right?

Mr. GUERTIN. Yes, about January 1, 1948, when the new laws came into effect in most States.

Senator KERR. Is not the effect of that change being felt progressively as we go along in the form of a steadily decreasing average required interest rate?

Mr. HOGG. I would think so, yes.

Senator KERR. Is that not one of the substantial reasons for the result which you gave me here awhile ago in the decline from 88 percent in 1951 to your figure of 76.76 in 1955?

Mr. HOGG. It may be. I would like to call on my actuarial cohorts here to take over from here.

Senator KERR. No, no.

Mr. HOGG. You are not going to let me go, then?

Senator KERR. No, no. I like you. I would be glad to have him give you the figures.

Mr. HOGG. Come up here and hold my hand, somebody.

I have more Edgar Bergens.

Senator KERR. I am afraid that is true. I want to say this, though, that if I were to apply the elements of that great team to this situation, I would reverse it.

Mr. HOGG. I might say this, in this one instance——

Senator KERR. I would say that you were the Edgar Bergen, and that you have more Charlie McCarthys and more Mortimer Snerds around.

Mr. HOGG. You do not know these people.

I think you asked whether or not the use of the new standard nonforfeiture and valuation laws which are the Guertin laws, and here is the gentleman sitting here who helped with them, has resulted in a progressive decrease in the interest requirements of the business since 1948. Am I correct?

Senator KERR. Steadily decreasing average interest rate.

Mr. HOGG. I left out "average." I will put that in. What do you say about that?

Mr. GUERTIN. Mr. Chairman and Senator Kerr, the new laws established new mortality tables.

Senator KERR. I am not talking about mortality tables now. If you need to bring that in to answer the question, that is all right.

Mr. GUERTIN. It did continue at the same time these and existing maximum rates at which companies could calculate reserves. However, companies had been earning a declining rate of interest on their investments over a period of years and with a major change in all of their policies it made a very opportune time for them to assume lower rates of interest which they probably would have had to assume in any case.

Senator KERR. That is, they were required to earn on their reserves.

Mr. GUERTIN. Yes.

Senator KERR. Now then, I ask this question, if the effect of that change is not substantially responsible for the fact that the amount

of your earned income necessary to meet reserve and other policy requirements——

Mr. HOGG. You might nickname that——

Senator KERR. Has been steadily decreasing as evidenced by the figures which Mr. Hogg and others have given us here, that range from 87.88 in 1951, down to 72.6 in 1955.

Mr. GUERTIN. Yes; it is partially responsible.

Senator KERR. I did not ask if it was entirely. I asked if it was not substantially responsible.

Mr. GUERTIN. It will be responsible—it will have its major effect possibly some 5 or 10 years from now.

Senator KERR. Do you anticipate, then, that this percentage will continue to decline?

Mr. GUERTIN. It is possible that it could decline in connection with certain business that is already on the books and if companies should assume different rates on new issues that would have a tendency to raise it.

Senator KERR. We are talking about the present rates. They are still in effect, are they not?

Mr. GUERTIN. On existing policies; yes.

Senator KERR. And on new business?

Mr. GUERTIN. On new business, where the reserves are very small——

Senator KERR. You do not have a different requirement on the new business you write this year, than you did on business you wrote last year, do you?

Mr. GUERTIN. That is possible; it is probably true in the case of some companies.

Senator KERR. Is it false in reference to others?

Mr. GUERTIN. I beg your pardon?

Senator KERR. I am just trying to get the facts here. I am not trying to get any misrepresentations in this record. And I am sure that you are not.

Mr. HOGG. It is a function of management. It is a function of management.

Senator KERR. I asked you when they started to issue new contracts providing for lower reserve interest. You said in 1948 or 1949 or somebody did.

Mr. GUERTIN. Yes.

Senator KERR. Is that not still the situation?

Mr. GUERTIN. In determining a rate of interest, Senator, in the issue of new contracts, ordinarily all factors——

Senator KERR. I am talking about this one factor.

Mr. GUERTIN. All factors that apply to the rate of interest will be taken into consideration and if there is a tax consideration it would probably be given appropriate weight. And if the tax law were so geared that there would be such an advantage, it is possible that some companies would take it into consideration, also, with other factors.

Senator KERR. Just barely possible. You make this very difficult, because I am trying to put information into this record, and I do not get the impression that you are trying very hard to give it. Is that opinion justified on my part?

Mr. GUERTIN. No. I am sorry, Senator, if I have given that impression, but that certainly is not the impression that I am trying to convey.

Senator KERR. You are giving me very little information when you tell that a certain situation went into effect in 1948 or 1949, and I asked you if it is not still generally in effect, and you say that that is barely possible with reference to some situations.

I want to say that is limited in the information that is intended.

Mr. GUERTIN. May I repeat the answer to that question?

Senator KERR. I see no reason to repeat it. I would be glad for you to give it in such a way that it might be possible that I understand it better or get more information from it.

Mr. GUERTIN. With respect to policies issued prior to 1948, the rate of interest assumed is high. It has been reduced in some cases by the strengthening of reserves.

With respect to policies issued since 1948, to use a round date, the rate of interest is considerably lower.

The effect of that will continue as long as those policies are in force. There is no question about that.

Senator KERR. Well now, what about policies issued this year and the interest rate on them—is it still at that reduced level?

Mr. GUERTIN. It will continue at that reduced level.

Senator KERR. Period—now, if you will stop right there, I will understand you, but if you are going to start qualifying it, you lose me.

Mr. GUERTIN. I have called the opinion of the Senator that if there are tax incentives, the policies issued, let us say, in 1955 or 1956 could be pretty well revamped and could go back to any rate of interest that is permitted by law which in most States is 3.5 percent.

Senator KERR. Are you telling this committee that you fix the interest rate on reserves to meet the requirements of the integrity of your obligation on the basis of what may or may not benefit your company taxwise, instead of on the basis that will enable it to meet its obligations?

Mr. GUERTIN. No, sir.

Senator KERR. I did not think you were. And if you are, then I think you ought to make it clear.

Mr. Hogg, whom did you say you were associated with?

Mr. HOGG. The Equitable Life Assurance Society of the United States.

Senator KERR. Have you a table there showing the experience of the Equitable Life Assurance Society with reference to the percentage of——

Mr. HOGG. We will have to nickname that—we will nickname that as also a hard thing for me to get across, reserve and other policy liability deductions.

Senator KERR. Have you got the experience of your company as to what percentage of its free income is required to meet those obligations?

Mr. HOGG. I think Mr. Peterson might give that to me, or somebody back there. I cannot give it. That shows how little I know about it.

Senator KERR. I want to tell you that I am not going to be a party to either demonstrating or indicating that you know little about this. I think that you did well.

Mr. HOGG. Can I quote you on that?

Senator KERR. Yes, sir.

Mr. HOGG. For 1954 our effective gross rate was 3.14 or 3.15 after taxes on all of the investments.

Mr. PETERSON. In 1954 our earned rate was in the neighborhood of 3.14, and our reserve requirements—this is approximate—probably in the neighborhood of 2.9.

Mr. HOGG. Does that give you the information?

Mr. PETERSON. That is the business as a whole including insurance and annuities.

Senator KERR. Whether or not you have a table showing the percentage of this designated income over the last 5 years, and including this year, required to meet reserve and other policy requirements, I should like to inqure.

Mr. PETERSON. No, sir; I do not have those individual company figures.

Senator KERR. Well now, who might be able to give us that?

Mr. PETERSON. We can certainly get them, sir, and put them in the record.

(The following letter gives the figures referred to in the foregoing question and answer:)

AMERICAN LIFE CONVENTION
Chicago, Ill.

LIFE INSURANCE ASSOCIATION OF AMERICA
New York, N. Y.

JULY 26, 1955.

Re H. R. 7201.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington 25, D. C.

DEAR SENATOR BYRD: During the course of my testimony yesterday, I was interrogated at some length as to the justification of the average 85-percent figure in the reserve and other policy liability deduction applicable to regular life-insurance operations. This 85-percent figure being the business average, I was asked for figures as to my own company, the Equitable Life Assurance Society of the United States. Our 1954 figure is 85.6 percent. In other words if, instead of taking the average figure in the bill, we were to apply our own experience, our deduction would be increased to 85.6 percent and our tax liability correspondingly decreased.

We do not have immediately available the same information for previous years but the figure would be higher in each of these years. We do have figures for our entire operation and they are as follows:

	Percent		Percent
1950	92. 4	1953	83. 7
1951	89. 3	1954	78. 2
1952	86. 6		

Since these figures include both approved pension operations and individual annuity operations, they obviously understate deductions contemplated in H. R. 7201. As an illustration as to our overall operations for 1954, the ratio for required interest to investment earnings was 78.2 percent instead of 85.6 percent which would be applicable to H. R. 7201 on an individual company basis.

Yours sincerely,

ROBERT L. HOGG,
Chairman, Joint Committee on Federal Income Taxation of Life Insurance Companies.

Senator KERR. Can you tell me whether or not, assuming that your business experience is the same in 1955 as it was in 1954, that

your company will pay a greater amount of taxes to the Federal Government under H. R. 7201 or under the present law?

Mr. HOGG. We will pay less. We will pay, if you would like to know, I can give you the amount—I will be glad to give you the amount. Probably we would pay about $300,000 or $400,000 less in 1955.

Senator KERR. Than you did in 1954?

Mr. HOGG. Than we did in 1954, yes.

Senator KERR. Yet the industry as a whole would pay $26 million more?

Mr. HOGG. That is right—that is right. I want to say, also, to point out that there is brought into this bill this new change in the accident and health operations which increases the yield in the formula considerably. We will pay an addition of one-half million on that new formula there.

Where we get our relief, Senator, is in the pension-plan area. I am glad you brought it up.

Senator KERR. I did not bring it up. You are bringing it up.

Mr. HOGG. Let me put it this way, I would like to bring it up.

Senator KERR. You may do that.

Mr. HOGG. I do not want to interrupt you, but I say the point is that we feel that this matter of relief, Mr. Chairman, in connection with the pension plan setup is an issue entirely separate and distinct from this tax proposal. I will tell you why I say that.

The business has uniformly endorsed relief in this area. And we have made presentations to the Treasury Department. We made one in connection with the 1954 revision of the Revenue Code. We had it in there. And it was recognized at that time but that it was indicated that relief should be taken in a subsequent life-insurance-company tax bill.

We get probably more relief under this than most companies because of the fact that we are the largest holders of group annuity business which is the pension-plan operation. And we are the largest holders of individual annuity business. As a matter of fact, the group annuity and the individual annuity business represents approximately 52 percent of our assets.

Somebody asked a while ago about the improvement in mortality. If you stop to think a minute the improvement in mortality in the life-insurance business works the other way from the standpoint of annuity. So that we are in a rather unique situation.

Those are some of the highlights why we feel and justly can claim a little bit of relief in this competitive picture.

Senator KERR. If he gave me this information, I did not understand it, and if he did, I would appreciate your repeating it. With reference to your own company, you paid 6.5 percent for the current year of your free investment income, did you not?

Mr. HOGG. That is correct, yes—6.5 percent. That is in 1954, on that business. We paid 6.5 percent on 1954 business.

Senator KERR. Can you tell us how much that amounted to?

Mr. HOGG. I think I can. We paid $15,555,562, according to the figures I have here. Am I quoting the correct figure? I have two pages here and I am confused sometimes by some of these. I think I have seen the right line. I think the staff has the tabulation of all of the companies.

Senator KERR. I know that they have. What percent of your total free investment income was necessary to meet your reserve and policy requirements?

Mr. HOGG. I cannot tell you specifically, but I would be very glad to furnish it.

Senator KERR. Is there anybody in the room that can?

Mr. HOGG. Can you furnish that, Mr. Peterson?

Senator KERR. Now—if that same percentage were applicable to 1955, that is, the 6.5 percent, would your company pay more taxes or less taxes that in 1954?

Mr. HOGG. We would pay more in 1955, assuming these other relief provisions are not in the measure. That is correct—that is correct.

Senator KERR. But if H. R. 7201 is passed, then you would pay less in 1955 than in 1954?

Mr. HOGG. That is correct.

Senator KERR. Mr. Chairman, that is all for the moment. If we go further into this, I shall have further questions. I want to thank Mr. Hogg for his very cooperative and estimable attitude. I want to congratulate him far more upon the answers he has given than those he has obtained from others.

Mr. HOGG. You almost had me on the fringe there once or twice.

The CHAIRMAN. I would like to ask what other large companies would pay less taxes under this bill than they have been paying, Mr. Hogg.

Mr. HOGG. I would dislike to hazard a guess on that. I suppose because it is a pretty important figure. I think you gentlemen have them up there. I would much prefer to rely upon the figures which the staff furnishes. If you have not got them, we will be glad to try to get them.

Senator KERR. Could you furnish that information for the record?

Mr. HOGG. We will be glad to do that. About how many, 8 or 10?

The CHAIRMAN. You know which ones.

Mr. HOGG. Suppose we take the first 8 or 10.

Senator KERR. Just furnish the committee a list of the companies who would pay less under H. R. 7201 than they would under a continuation of the present law.

Mr. HOGG. That is right.

(The information referred to follows:)

A comparison of taxes payable by the 10 largest life-insurance companies in the United States under H. R. 7201 and the 6½ percent stop-gap bill on 1954 results

Company	Actual Federal income tax 1954 under stop-gap	Estimated tax on 1954 business on basis of H. R. 7201
Aetna Life Insurance Co.	$5,617,000	$6,330,000
Equitable Life Assurance Society of the United States	15,556,000	15,159,000
John Hancock Mutual Life Insurance Co.	7,920,000	8,610,000
Massachusetts Mutual Life Insurance Co.	3,463,000	3,894,000
Metropolitan Life Insurance Co.	27,388,000	31,161,000
Mutual Life Insurance Co. of New York	4,900,000	5,757,000
New York Life Insurance Co.	11,090,000	13,036,000
Northwestern Mutual Life Insurance Co.	6,405,000	7,218,000
Prudential Insurance Co. of America	24,290,000	27,890,000
Travelers Insurance Co.	9,373,000	10,093,000
Total	116,002,000	129,148,000

Special deductions of 10 largest life-insurance companies under H. R. 7201 [1]

Company	Approved pension plan business	Annuities, deposits, etc.
Aetna Life Insurance Co	$953,000	$280,000
Equitable Life Assurance Society of the United States	2,795,000	1,568,000
John Hancock Mutual Life Insurance Co	1,120,000	400,000
Massachusetts Mutual Life Insurance Co	230,000	368,000
Metropolitan Life Insurance Co	2,187,000	742,000
Mutual Life Insurance Company of New York	27,000	431,000
New York Life Insurance Co	6,000	1,283,000
Northwestern Mutual Life Insurance Co	205,000	515,000
Prudential Insurance Co	(2)	(2)
Travelers Insurance Co	207,000	

[1] These deductions were taken into account when computing the total tax in preceding table.
[2] Figures to be supplied.

The CHAIRMAN. Then furnish the same list as to the larger ones that would pay more taxes.

Mr. HOGG. Yes.

(The information referred to is included in the memorandum appearing above.)

Senator FLANDERS. Mr. Chairman, I regret that I did not know that we were still in session; I should have remained here.

On this question of reporting what large companies would pay, more or less, I would like to have personally not merely the report that so and so pays more and so and so pays less, but state what it is in comparative bills or laws that makes the big company pay more or makes it pay less—not just simply the statement that they do, but explain why.

The CHAIRMAN. Mr. Hogg has already made an explanation.

Mr. HOGG. We will be very glad to supplement my statement with that information.

The CHAIRMAN. Are there any further questions?

Senator KERR. None from me, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Mr. HOGG. Thank you.

The CHAIRMAN. We will now adjourn.

(By direction of the chairman the following is made a part of the record:)

NATIONAL ASSOCIATION OF LIFE COMPANIES, INC.,
Atlanta, Ga., July 25, 1955.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: This association feels that additional study of the effect upon us of the pending Life Insurance Tax Act of 1955, in the form that it passed the House, is essential. In the course of the report, it was stated that the measure would result in an increase to $215 million compared to $190 million. This is an increase of 13.15 percent. Every report that we have received from a company that is a member of this association indicates that its increase will slightly exceed 20 percent. A comparison of these figures indicates, therefore, that decreases in existing taxes to a handful of companies will amount to $13 million.

Moreover, if the Treasury is to obtain from the life-insurance industry generally the same amount of revenue in succeeding years, the further reductions authorized in the bill of certain types of contracts will result in increasingly heavy taxes upon standard types of policies. Until a point will be reached where no stock company and few mutuals not engaged in noninsurance enterprises will be able to meet their reserve requirements without substantial upward readjustment of interest rates upon investments of all types, public or private.

Some aspects of the bill, upon a cursory examination, appear to be admirable. The close loopholes for tax avoidance and are desirable. It is not our desire to express at this time opposition to enactment of the measure. It is, however, our wish to draw attention of the Senate Finance Committee to the facts that: (1) the measure covers much material not discussed at hearings; (2) the measure was introduced on July 7 and passed before the industry generally, especially the smaller companies, had an opportunity to study its effect; (3) that the Congress will probably be in session during the fall and can give attention to the measure before January 1956.

Since the measure appears to vary so greatly from that which a broad segment of the industry anticipated, this association feels that delay and an opportunity for further study is most desirable.

Sincerely yours,

C. H. POINDEXTER,
Chairman of the Executive Committee.

LIFE & CASUALTY INSURANCE COMPANY OF TENNESSEE,
Nashville, Tenn., July 21, 1955.

Re life-insurance companies income-tax bill.

Hon. HARRY F. BYRD,
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: Our company participated in hearings held by the House Ways and Means Subcommittee on this subject, and we have followed with great interest the progress of the life insurance company tax bill which has now passed the House of Representatives.

We understand that there is a hearing with reference to the bill scheduled next Monday before the Senate Finance Committee of which you are chairman.

We would like to go on record as stating that we are satisfied with the tax bill in its present form. We feel that it is fair to the companies and to the Government, and that it would be hard to draft a bill which would produce less discrimination among the companies.

Therefore we are very hopeful that it will be possible for the bill to be reported out of your committee unchanged and passed promptly in the Senate.

Sincerely yours,

GUILFORD DUDLEY, Jr.

MUTUAL OF NEW YORK,
THE MUTUAL LIFE INSURANCE OF NEW YORK,
New York, N. Y., July 22, 1955.

Re H. R. 7201—Federal income tax on life insurance companies.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: I am writing to state very briefly this company's position regarding H. R. 7201.

Our views with regard to the Federal taxation of life-insurance companies were presented fully at the hearings on that subject held last December before the subcommittee of the Committee on Ways and Means of the House of Representatives which was conducting a study of that subject. They are set forth on pages 148–273 and 429 of the printed record of those hearings.

We believe that H. R. 7201 contains many improvements over previous legislation dealing with Federal taxation of life-insurance companies, and, to some extent, it incorporates the principles which we advocated before the subcommittee. Nevertheless, it is our firm opinion that the level of tax established by H. R. 7201 on life insurance places too great a burden on the millions of policyholders of mutual life insurance companies such as our own. This conviction rests upon an exhaustive analysis of the entire problem which we made over a period of months in an effort to find a permanent solution to a question which has vexed Congress, the Treasury and the industry since the first income-tax law. This analysis was contributed to by a number of highly qualified persons outside our own organization, as well as by our own officers and staff, and it was supported by a number of representatives of other companies at the subcommittee's hearings last December. A one-page summary is enclosed.

The basic principles are relatively simple. The application of those principles to the life-insurance industry, however, involves difficult and highly technical questions because of the complex long-term character of the business.

It would seem more appropriate to consider this entire subject further in the continuing study of life-insurance taxation which, we understand, is to follow the close of the present session of Congress, rather than to attempt to deal with it at the hearing before your committee on Monday. We consider it advisable, however, to acquaint you at this time with the general nature of our views.

We wish to say finally that we believe H. R. 7201 is very much preferable to a return to the 1942 formula which would result if no action were taken by Congress at the present session. For that reason, we hope that your committee will report it favorably.

Respectfully yours,

HAUGHTON BELL,
Vice President and General Counsel.

Identical letter to each member of Senate Finance Committee.

(Whereupon, at 1:30 p. m., the committee adjourned.)

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